UPDATED AND REVISED

WEALTH

GROW IT AND PROTECT IT

STUART E. LUCAS

Forewords by

JOE MANSUETO, Founder, Chairman, & CEO of Morningstar, Inc.

G. GARVIN BROWN IV, EVP & Chairman, Board of Directors, Brown-Forman Corp.

Praise for the Previous Edition of *Wealth*

"Finally...sage advice, now tested by financial crisis, from someone who manages his own family's wealth every day. *Wealth* is more than an excellent guide to personal financial management. You get straight talk about how to transfer values like entrepreneurship, fiscal prudence, and community leadership from generation to generation."

—Penny Pritzker, Chairman and CEO, PSP Capital Partners and Pritzker Realty Group

"Stuart Lucas has connected all the dots, from the first dollar you earn to the last dollar you give away. This book should be read and re-read by a large and growing audience."

—Robert W. Doran, former Chairman and Chief Executive Officer, Wellington Management Company, LLP

"Lucas draws from deep personal experience to offer us a rare look at the complex challenges for families who share ownership of assets. His eight strategic steps for managing assets provide unique insights of great value to other families who hope to pass wealth successfully to future generations. Even leading financial families will find this work essential to benchmarking their own financial process."

—Sara Hamilton, Founder and Chief Executive Officer, Family Office Exchange

"Lucas's unique background—as a financial manager and an heir to a significant family fortune—gives him valuable insights into the emotional as well as practical side of managing wealth. His concept of wealth stewardship will resonate with families who want to extend their legacies beyond the first generation."

—Liz Weston, Columnist for MSN Money and author of *The 10 Commandments of Money*

"*Wealth* addresses all the right questions. It has already helped me and my family think through what is really important."

—William J. Poorvu, Professor Emeritus, Harvard Business School

"...a perceptive, engaging, and valuable guide to wealth management. This book will not only improve and protect your financial wealth, it will also help keep your family together."

—Steven N. Kaplan, Neubauer Family Distinguished Service Professor of Entrepreneurship and Finance, University of Chicago Booth School of Business

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Stuart E. Lucas

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To Mom for being the glue,
To Dad for inspiration,
To Susan for her love,
And to our children for the future.

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Foreword to the Second Edition

I joined my family's controlled public company in 1996, as a wine salesman in New York City. I was 27 and newly married. The team there taught me a lot of things about our company, industry, and much more. There are stories from those days that I'll never forget. At the top of the list was a chat with a colleague, while we were stuck in traffic on the Pulaski Skyway, between Newark and Jersey City, trying to get to a sales call. It was ice cold, and, after too much time watching exhaust float into the steel ribs of the bridge, he eventually took me through the ups and downs of his own family's business before it was sold. Turning the corners of his mouth down, he advised calmly, "Never mix family and business." There was an awkward silence. "But what if it's too late?" I asked.

Suffice it to say, the average person would agree with my friend. Hollywood and the literary canon have had fun with the topic, too. So, if you meet someone who can grapple with this age-old subject, I recommend that you listen closely. Stuart Lucas is one of those people. Stuart has the rare and valuable mix of experience as both a professional investor and as a fourth-generation member of another business-owning family: His great-grandfather founded Carnation Company, which his family controlled until its sale to Nestlé in 1985. There just are not very many people like Stuart who "sit on both sides of the table," are able effectively to communicate their acquired knowledge, and who are also willing to share their family's experience with warmth and candor. He wears his wisdom lightly and is a joy to have in the mix. I have enjoyed working with and learned a lot from Stuart. I think you will, too.

For me, Stuart has brought yet another perspective on the value of holding onto a long-term operating business. In our case, that business is Brown-Forman, the company founded by my great-great-grandfather, George Garvin Brown, in 1870. I am one of the many members of the fifth generation of the Brown family who are actively engaged in the governance of the company. More than a dozen of us have roles on the board, in the company, or on our family committee. Brown-Forman started with the creation of Old Forester Kentucky Straight Bourbon Whisky, America's first bottled and bonded whiskey. Since that time, the company has expanded with the acquisition and development of other brands, including, of course, Jack Daniel's Tennessee Whiskey.

When we acquired Jack Daniel's in 1956, it was smaller than Old Forester and scarcely known outside of its home state or beyond the circles of a few connoisseurs. Today, it is one of the most widely recognized and valuable spirits brands in the world. And yet, as we say…while it is sold in over 160 countries, it still comes from a town with one stop light: Lynchburg, Tennessee. Jack Daniel's is a global success story, but it hasn't lost its way. The challenge for Jack Daniel's is the same as the challenge for any multigenerational family. How does your family grow, evolve, and spread its wings across the world, without forgetting its roots? How are children raised in ever-changing circumstances, without forgetting who they are?

Stuart's chapter on entrepreneurial stewardship is at the heart of these questions. He talks about kids growing up, education, careers, and communities. He also does a good job at turning the family tree upside down and looking at it through the lens of today's multicultural kids rather than through the prism of ancestral oil paintings and portraits. I can't recommend this view enough. Like anyone, I venerate the old black-and-white photos. I've even caught my breath, looking at tombstones that bear my name. But Stuart reminds us that it's about the future, not the past. His message to any business-owning family is that it needs to think about its children first and foremost, at the start of every day. Long-term strategy and family governance get built by all generations, but its principal benefactor is tomorrow's generation. Happily for their parents, when the next generation is given a sense of purpose and direction, they'll never forget their way home.

We are all inundated with information, from an ever-increasing multitude of sources, about the critically important topic of family wealth management. I find that Stuart's is a rare voice in that deluge: genuine, deeply knowledgeable, credible, and pragmatic.

G. Garvin Brown IV
October 2012

Geo. Garvin Brown IV is part of the fifth generation of Brown family members engaged in the governance of their family's company. He is an Executive Vice President of the company, the Co-chair of the Brown-Forman/Brown Family Shareholder's Committee, and the Chairman of the Board of Directors.

The views expressed in this foreword are the personal views of the author and do not necessarily reflect those of his employer, Brown-Forman Corporation, or anyone else.

Foreword to the First Edition

I recently asked my wife who she would consult for advice about our financial situation if I were hit by the proverbial bus. Stuart Lucas was the first name she mentioned. I think I know why. Stuart is smart and savvy about wealth management. He engenders a high degree of trust. And he does everything in a measured, well-reasoned way. We have enjoyed getting to know Stuart and his family over the years. As you read this book, I believe you will share our appreciation.

Creating trust is essential for anyone who offers advice about wealth management. In an age where everyone seems to be selling something, how do you know who will really put your interests first? More than ever, investors want independent and unbiased sources of advice. As head of Morningstar, I realize that the trust we've built over the years is essential to our success. You'll also discover that Stuart is a person of high integrity who is out to do his best for every reader.

As a fourth-generation heir of E. A. Stuart, the man who founded the Carnation Company back in the late 1800s, Stuart knows firsthand the privileges, challenges, and responsibilities of wealth. His family's approach to wealth management is a backdrop to this book—a peek through the window that you rarely experience. This gives *Wealth* unusual credibility. The author is practicing day-to-day—with real dollars—the lessons he prescribes. That seldom happens in the world of investment advice, where recommendations tend to be offered enthusiastically by those who have little at stake in the outcome. The hands-on examples here are useful for everyone, regardless of the size of your fortune.

Stuart and I share many basic beliefs about wealth management. Most important, we both have an investor's perspective. "Investors come first" is Morningstar's mantra, and you'll see in this book that Stuart approaches investing in exactly the same way. He offers insightful and practical advice. He seeks to empower investors and to give them the knowledge and tools they need to make wise decisions.

The first of the eight principles that Stuart uses as guideposts is the need to "take charge." He explains the importance of accepting responsibility—both for setting strategy and for making sure that things stay on course. Then, and only then, can wealthy individuals delegate to the experts effectively. Stuart shows, through personal experience, how his own family learned the importance of this insight. Even with access to elite professional talent, simply delegating to the experts turned out to be a mistake.

Another piece of advice that I love is Stuart's suggestion that wealth owners send an "RFP" or "request for proposal" to wealth management firms. This can trigger a competitive bidding process, which will help you understand the services you're receiving. It also ensures that things are competitively priced. This is a simple idea and something that's rarely done. But it's grandly empowering for investors.

I also applaud Stuart's holistic approach. He articulates a comprehensive, strategic view of wealth management that integrates all the issues that individuals (and their advisors) need to think about. This requires knowledge across many disciplines—investment, asset allocation, risk assessment, taxes, philanthropy, and estate planning. Many authors focus on just one aspect of the process. Their readers must figure out how to integrate and manage everything. Because he's done all this, real-time, Stuart packages advice for his readers in an understandable, cohesive *framework.* That's highly valuable.

One of our goals at Morningstar is to bring greater transparency to the mutual fund industry. I see *Wealth* as a clarion call to do the same thing in the world of wealth management. Compared to the mutual fund industry, clients of wealth management firms have much less data available to help them make informed decisions about which firms to retain. There are no benchmarks that customers can use to gauge how well they're being served. There are, of course, superb wealth advisors in the marketplace. Many are Morningstar customers. But it's tough to compare one with another in a way that allows you to identify with confidence who has the best record. Reading *Wealth* will help you do this with greater confidence.

I expect that the top wealth management advisors will read this book and share it with their clients. Better-informed investors will choose better advisors, and they'll hold advisors to a higher standard. In turn, the advisors who do the best jobs of serving their clients will see their businesses prosper. It's a win-win situation.

Stuart's life revolves around his family and so does his approach to wealth management. Most books deal with this subject from an individual's perspective. It's much more difficult when a family is involved. Stuart explores the often complicated interplay between family members and family wealth, and he stresses the importance of creating a wealth plan that reflects a family's values and purpose. He also offers solid advice about family-related topics that touch on wealth management, such as parenting, education, and careers—all the while generously sharing his own family's experience.

I find it refreshing that Stuart offers a broad definition of wealth. To him, it means far more than how much one has in a bank account or the stock market. Being wealthy is about being productive, giving to others, serving society, and creating a legacy. Perhaps, most important, though, it's about taking the risks and responsibilities necessary to manage one's assets and teach one's children to do the same. Wealth, in other words, is a tool to help people across generations live more productive and fulfilling lives, and to be good citizens. To me, that's a more exciting and fulfilling proposition than merely worrying about being able to buy your next yacht.

I believe that this book will help you manage your assets more effectively. But it just might inspire you, too—and help you see the full potential that your wealth can provide. The thing I admire most about *Wealth* is that Stuart places values squarely at the center of things. That notion is sadly missing from most investment planning discussions. Without values, you don't have wealth, just money.

Enjoy!

Joe Mansueto
Founder, Chairman, and CEO
Morningstar, Inc.

Acknowledgments

The experience of writing *Wealth* has been more rewarding than I could have imagined. Perhaps its greatest rewards come from the help, support, and encouragement I have received from so many people because they believe in the book's purpose and they trust me to do the subject matter justice. To all of you I owe a great debt of thanks.

In the early days of the project, Howard Stevenson at Harvard Business School encouraged me to use my family as a case study for the book and stimulated my thinking on a number of issues, many of which tie back to his own fine book on success and significance, *Just Enough.* Paul Sturm, an experienced journalist and Director of Morningstar, helped me to navigate the publishing world and led me to my wonderful agent, Doris Michaels, and ultimately to Jim Boyd at FT Press. Both Doris and Jim had strong hands in shaping the book's tone and defining its audience, and I deeply appreciate their support and encouragement of me in the book writing process. Jim has also assembled a superb team. Kayla Dugger and her production team, Dan DePascuale, Jim Schachterle, and others have worked many hours to perfect and promote the book. Plus, they have been professional and a real pleasure to work with. I can only say the same of Lisa Berkowitz, my publicist. She has been tireless in getting the word out.

Doris also introduced me to Richard Koonce. Rick and I worked intensively together over 18 months to bring my dream to life. As my editor, he has been a great partner. We bring different skills and perspectives to the table, and Rick has never been shy about expressing his views clearly and professionally. It was when we didn't agree that the partnership was at its strongest. We pushed each other, sometimes hard, until we found the right solutions. Rick handled these debates with great professionalism and grace, and without ego. He's also a darn good writer.

Numerous people in the financial business have been a great help along the way. Bob Doran at Wellington Management Company showed me by example how a great investment business is managed, and I am grateful for his continuing advocacy on my behalf. Jeff Thomasson, Jon Hirtle, and Shelby Notkin personify professionalism, integrity, and best practices in everything they do. Lorraine Tsavaris, Ralph Rittenour, Andy Eberhart, Susan Johnston, Karen Harding, and other folks at U.S. Trust and CTC Consulting have been strong supporters and suppliers of data that help to reinforce my message. Mark Augenstein, my wonderful accountant, was also kind enough to read through several chapters and impart his wisdom.

Joe Mansueto, tennis maestro and the soft-spoken founder and CEO of Morningstar, is a busy guy. Yet he believes so strongly in this project that he was willing to carve out the time to read the manuscript and write a compelling foreword to this book. Thank you.

I also want to thank my friend Garvin Brown for being an inspiration to me as I watch him work with his large multigenerational family and their family business. He also generously agreed to write the foreword to the second edition.

Others I want to thank include Tim Dolan, because he always makes me think; Scott Dille, my friend and former boss at Bank One; Cynthia Wambold, for making the graphics comprehensible; and Jim Eckstein, for a real-time case study. My gratitude goes also to my friends Martin Alderson Smith, Etienne Boillot, Ted Hibben, Tracy Weisman, Brian Miner, Lyle Logan, the Rosenbergs Senior and Junior, Alex DuBuclet, and Linda Litner. All of them read drafts of various chapters, contributed ideas, and offered praise that helped me convince FT Press to take on this project. I also want to thank the members of the Harvard Business School personal finance group in Chicago for reading an early draft of my work and providing both useful feedback and solid encouragement.

From the start, my friend and esteemed professor of finance Steve Kaplan encouraged me to keep refining the processes I use for setting wealth management financial strategy; he was always there to help with tactical introductions, the right answers to my technical questions, and the leadership to start the Private Wealth Management Program at Chicago Booth.

Bob McDermott and his late wife (and legal partner), Jane, have had a profound effect on my family that goes far beyond my book. Their professional and practical advice has been enormously valuable to us over the decades. I got help of a different sort from Jack Lanphar. Starting more than ten years ago, Jack figured out how to make things happen that seemed impossible.

I received valuable input from still others in the writing of this book. They include Ken and Peter Lehman, Penny Pritzker, John Manley, Jack Polsky, Lenny Gail and Robin Steans, Peter Goulds, Matt and Kay Bucksbaum, and Will Doheny. Each generously added his or her perspective, shared ideas, and kept me thinking broadly about the issues that wealthy individuals and families face.

Three other friends with experience in publishing and media, Christopher Ainsley, Gary Lucido, and Bob Reichblum, spent hours brainstorming with me about how to hone this book's message and create a breakthrough model for the strategic management of wealth across multiple generations. Sara Hamilton at Family Office Exchange and I have had numerous conversations about wealthy families and their needs, and she has been a strong supporter of the book and my ideas.

One of my toughest critics is my mentor, friend, and fellow NPR Foundation Board member Bill Poorvu. Bill has taught me so much about investing, managing meetings, philanthropy, and values. His wisdom about business and also about life is truly inspirational to me.

José Ramon Sanz has become a close friend, inspiration, and fellow educator. We've worked together for five years building the Spanish Private Wealth Management Program, including families from Latin America. He has taught me many things, but maybe the most important is the obsession with "continuous improvement" mixed with "Don't worry, be happy."

No doubt, the bravest supporters of this project have been members of my family. Eight years ago, a group of about 12 people—cousins, parents, and siblings—came together at my request to learn about my desire to write this book and to highlight the family's experience. Many in the group were tentative about the idea of incorporating our family's story into this book. Despite their reservations, they trusted and supported

me 100%. It's my firm hope that this book does justice both to their faith in me, and to our family's heritage and values.

There are three family members to whom I owe a special debt of gratitude. Dad, my brother William, my sister-in-law Melissa, and I built our family office. Although the office and our roles have evolved, their thinking touches every aspect of this book.

A special thank-you goes to my wife, Susan, and to our three children. At times, this project consumed me. You have taken it all in stride and been supportive throughout. You are the very best that I could ever hope for!

About the Author

Living with wealth, managing its complexities, investing it for the long run, using it to advance worthy causes, and perpetuating his family's legacy are all topics **Stuart E. Lucas** knows a great deal about. For over 30 years, he's lived a double life, both as a member of one of America's wealthy families and as a senior executive in prestigious wealth management and investment firms.

Lucas is a fourth-generation heir of E. A. Stuart, founder of the Carnation Company, best known as the maker of such all-American food products as Carnation evaporated milk, Friskies pet food, Coffee-Mate nondairy creamer, and Contadina food products. In 1985, the Stuart family sold Carnation to Nestlé, the Swiss-based global food giant.

Today, Lucas is Chairman of Wealth Strategist Partners LLC, an investment advisory firm that provides an outsourced Chief Investment Officer service for individuals and families (including his own) of significant net worth. An accomplished speaker and educator, Lucas designed and teaches the Private Wealth Management program, exclusively for wealth owners, at the University of Chicago Booth School of Business.

Lucas has a long-standing commitment to public service. He serves as a Director of the Stuart Foundation, which supports public education and child welfare programs in California and Washington. He also serves on the Investment Committee of National Public Radio in Washington, D.C.

Lucas was formerly Senior Managing Director of the Ultra-high Net Worth Group within Private Client Services at Chicago-based Bank One. During the 1980s, Lucas worked for Wellington Management Company, serving for three years as General Manager of the firm's European business operations and before that as Assistant Portfolio Manager of a Forbes Honor Roll mutual fund.

Lucas has a bachelor's degree with high honors from Dartmouth College, has an M.B.A. from Harvard Business School, and is a Chartered Financial Analyst. He is married with three children.

Introduction

Question: What's the best way to make a small fortune?

Answer: Start with a big one.

This book focuses on what an individual like you and families like yours can do to protect and grow your wealth, share it with others, and build lasting personal and family legacies based on it. The lessons learned and shared here come from my many years as a wealth industry professional combined with the experience of representing my family as longtime clients of the industry. There is value in having sat on both sides of the table, and I want to share that value with you.

Whether you are building your wealth over time or acquired it suddenly, whether you have a few hundred thousand in assets or a few hundred million, whether your family situation is simple or complex, the principles discussed in this book will help you sustain, grow, and, most important, enjoy your wealth.

Everyone dreams of striking it rich—by selling a business, scoring a great investment, receiving an inheritance, or winning the lottery. In fact, most people generate their wealth, small or large, by patiently accumulating and nurturing their asset base. Either way, integrating all the components of wealth management into a coherent, satisfying whole is the challenge we have before us.

I was one of the lucky ones because I was born into a wealthy family. For me, the dream began with $25,000 and the founding of what became the Carnation Company by my great-grandfather E. A. Stuart in 1899.

Eighty-six years later, the company was sold to the Nestlé Corporation for $3 billion, and I am a beneficiary of that wealth. But I am even luckier because I've drawn perspective from a thoughtful family legacy and over a quarter century of working in financial services.

I've used this perspective to build a flexible framework that can be customized to the unique circumstances of anyone who cares about managing their wealth. That's what this book is about. My hope is that you'll use this framework to protect and grow your own wealth, share it constructively with those you love, enjoy financial security, and build a lasting personal and family legacy.

But first, I will share a little personal and family history so that you can see firsthand where I'm coming from.

Good Idea, Bad Start

The story of Carnation's founding and of E. A. Stuart's pluck and grit in revolutionizing the production of fresh, safe milk products at the turn of the 20th century is the stuff of American history. So too is the fortune he amassed in bringing these products to your grandparents, your parents, and now your kitchen table.

Back in the late 19th century, E. A. Stuart had a dream of making wholesome, good-tasting milk as available to the Americans of his day as sugar and salt. So in 1899, he co-founded the Pacific Coast Condensed Milk Company and spent $25,000 to buy the rights to a process for producing evaporated milk.

The circumstances surrounding E. A. Stuart's purchase of his new milk production process were hardly auspicious. In fact, in the beginning, they had all the markings of a business disaster. At first, poorly sealed cans of evaporated milk spoiled by the wagonload after leaving Stuart's plant near modern-day Seattle, Washington. Making matters worse, local customers in those days weren't convinced they needed his product anyway, not in a region where cows dotted the lush local countryside and fresh milk flowed as plentifully from local pastures as cold, clear water did from local mountain streams.

But my great-grandfather persisted. “Pluck wins. It always wins,” he used to say in those challenging and sometimes dark early days. Showing flinty resolve, he perfected his milk evaporation process and improved his canning procedures.

When Opportunity Comes Face to Face with Hard Work and Preparation

Then luck struck. Or as some might say, “Opportunity came face to face with hard work and a lot of preparation.” Just as Stuart perfected his production techniques, demand for evaporated milk skyrocketed as gold prospectors swept through Seattle on their way to Alaska to join the great Klondike Gold Rush. Prospectors started buying it off the shelves as fast as my great-grandfather produced it. By 1909, Carnation had grown from one plant to seven, and sales had gone from nothing to over $4 million a year. At 10 cents a can, that meant 40 million cans of evaporated milk were being produced each year.

Stuart’s production process was extraordinary because it took about 60% of the water content out of dairy milk, thus making it easy to transport and store without refrigeration. Stuart, it seems, was in the right place at the right time. His perseverance, discipline, hard work, and faith—plus a little luck—launched the Carnation Company on the path to becoming a multibillion-dollar global food company.

Three generations later, the Stuart family hit pay dirt again. In 1985, international food giant Nestlé bought Carnation for $83 a share, or about $3 billion in cash. That price was nearly double the stated value of the company just a few years earlier and, at the time, was the highest price ever paid for a food company. Our extended family, which had much of its wealth tied up in the nearly 27 percent of Carnation stock it controlled at that time, suddenly landed on the Forbes 400 list of the wealthiest families in America, with close to $1 billion in collective assets!

It was an exciting time for us. We had achieved the American dream. In one fell swoop, we became wealthy beyond our wildest hopes and expectations. But therein lay the seeds of a problem.

Since Carnation's founding in 1899, members of my family had always identified closely with the company and all it stood for. The company had five presidents, three of whom were Stuarts. And even though H. Everett Olson, Carnation's CEO and the Chairman at the time of the sale, wasn't a family member, Wall Street and the business press always described the Carnation Company as "a tight-knit family enterprise."

End of an Era

The day that company executives sold Carnation to Nestlé, all of that changed. Our family's wealth, most of which was tied up for almost a century in Carnation stock, suddenly became liquid. And the family's ties to Carnation, the company that for years prided itself on giving Americans "better milk from contented cows," were suddenly severed.

The aftermath of Carnation's sale to Nestlé offered my family a unique opportunity to decide how its members would relate to one another now that they no longer had a day-to-day business to run. But that also posed some unique challenges: challenges of identity, purpose, leadership, and family legacy. Carnation had been my family's life and work for 86 years. Now that it was gone, what would we do? In the early 1900s, when my great-grandfather had first thought about selling Carnation, his son, E. H. Stuart, Carnation's second president, pleaded with him not to. "If you do, I won't know what to do with myself," he said. Now that reality had come to pass. And we, E. A's descendants, had to deal with it.

No Strategic Approach to Wealth Management

Carnation's sale to Nestlé precipitated a crisis for our family in three ways.

First, our family never anticipated the sale of Carnation. So our family never adopted a coordinated approach to managing our wealth, should that eventuality arise. Thus, in early 1985, when Carnation's sale was consummated, assets of nearly $1 billion suddenly got divided among a large number of Stuart family members. Less than a decade later, there were at least seven different Stuart family branches, each pursuing its own investment goals and strategies—with widely varied results.

Second, after the company's sale, our family no longer had a single focal point for its identity. So our common family heritage and history began to slip away. My great-grandfather and Carnation's founder, E. A. Stuart, died in 1940. His son, E. H. Stuart (my mother's father), passed away in the early 1970s. Within a year of the company's sale, not a single Stuart family member worked for Nestlé. The last family member who worked there quipped to me, "The Stuart family connection went from being an asset to a liability."

Third, after Carnation was sold, our family's wealth was reinvested in mixed stock/bond portfolios that yielded yearly dividends. But these new investment funds couldn't begin to match the average annual growth rate of 13% that Carnation stock had enjoyed from 1899 to 1985. In fact, income distributions to Stuart family beneficiaries started to decline in the early 1990s. Soon, some members of my family, who were dependent on investment income for their lifestyles, began to emphasize fixed income investments more than in years past—a move that was destined to further erode our wealth if we weren't careful.

All of this caused me to look at the Lucas branch of the family—my parents, my siblings, and our children—with a great deal of concern. By this time, I had spent more than ten years in the investment and wealth management industries. After graduating from Dartmouth in 1981, I had gone to work for Wellington Management Company, an investment management firm that manages hundreds of billions of dollars in assets. Over the years, I also became deeply involved in our family's financial and investment affairs as part of the Lucas family office.

My experience at Wellington Management gave me superb on-the-job training as an investment analyst, and as I looked over the state of our investments, I didn't like what I saw. The performance of our funds under the trustee who oversaw our family's assets was mediocre at best—to the limited extent I could measure it.

Alarm Bells

Between 1987 and 1994, the U.S. stock market grew a whopping 133% while the bond market grew 92.4% in value. That meant that a portfolio of 60% stocks and 40% bonds like ours should have grown 117% over that same seven-year period. But to my shock, my family's portfolio had not. In fact, my research showed that during the roaring bull market from the late 1980s into the mid-1990s, the value of our main portfolio grew only 31%. Taking inflation into account, this meant we hadn't really increased the value of our wealth at all.

It's Hard to Grow Assets AND Enjoy the Fruits of Success at the Same Time!

So where was the problem? First, I discovered that there were significant "costs" associated with our wealth that were continuously dragging down the value of our assets. To maintain the existing value of our assets—after distributing roughly 4% a year to family members, paying taxes, paying our investment advisor, paying brokerage fees, and adjusting for inflation—we had to generate roughly 9.5% a year in asset value growth. But because 40% of our assets were invested in bonds, the value of our stock holdings actually had to grow at an annual rate closer to 12%, almost the same 13% average annual growth rate that Carnation stock enjoyed year after year, decade after decade!

But that wasn't all.

Over time, to enjoy the same level of investment income from family trusts that my parents enjoyed, I realized it wouldn't be enough for us just to maintain the value of our assets. We had to increase their value because our family was getting bigger. I have three siblings, and among us we have nine children. If we wanted to live as well as my parents, we would have to generate not 12%, but nearly 17% growth in our stock portfolio year after year for the next 50 years. That's impressive even for someone like Warren Buffett to achieve!

My fellow family members and I always assumed that there would be plenty of money to pass on to our children and grandchildren. But that assumption, I realized, wasn't accurate. Even if we maintained our family's assets in the coming years, spending what we earned net of fees, taxes, and inflation, it became clear that each of my children would have nearly 90% less wealth than my parents simply because the family was increasing in numbers. Growing up, I'd often heard the expression, "from shirtsleeves to shirtsleeves in three generations." Now, I realized what that expression really meant. And I didn't like its implications.

Clearly, none of us was about to starve or see a significant near-term change in our lifestyle. But with an eye toward the future, and on what each of us wanted to do next in our lives, my family and I realized that the fortune my great-grandfather and grandfather built, which had been lovingly preserved in family trusts, wouldn't last another 86 years. My generation would have to work just as hard and be just as entrepreneurial to build our family's assets for the future as our forebears had done in the past if we didn't want to preside over a crumbling legacy.

Our Wealth Represented More Than Cash

I realized something else too. Our family's money represented more than just cash. It represented risk taking, serving customers well, perseverance, history, love, and aspirations for a better future—a tangible gift from past generations of Stuarts to my own. It was meant to last a long time and to be used in ways that would benefit not just my family and me, but also society and generations of Stuarts yet unborn.

We Needed to Get a Handle on Our Investment Portfolio

My family and I needed to get a handle on the long-term management of our wealth. Otherwise, we wouldn't have a family fortune anymore—only the memory of it. What could we do to reverse the tide of our financial fortunes? Crafting a solution demanded the use of all the financial and business training I was fortunate to get at the Harvard Business School and in the volatile business of investment management. When I understood the extent of our family's long-term asset-erosion problems, I presented the facts of our situation to my family. Talk about breaking a family taboo! Can you imagine convening a meeting of your family members to discuss the family's financial health? I can and did, and by reading this book, you'll be able to do it as well.

Introducing Strategic Wealth Management

I persuaded my family that we needed to take a disciplined and coordinated approach to what I call "strategic wealth management." Strategic wealth management is a philosophy and approach to wealth building that involves a number of key components: defining family purpose; setting goals for investments, family businesses, and individual careers; deciding on a time horizon for wealth management planning (your lifetime or multiple generations); asset, liability, and cash flow management; control of spending; wealth transfer; and tax and risk mitigation—all coordinated in a strategic, synchronized way that results in the whole being worth more than the sum of the parts. Strategic wealth management is a comprehensive approach to managing wealth productively in which synergies come from careful planning and from leveraging a family's assets in purposeful ways, not just for a lifetime, but, in our case, for multiple generations. It's also about respecting each individual family member and committing ourselves as a family to helping each one of them to lead productive, happy lives. Remember our American Declaration of Independence; what has made our country great is respect for life, liberty, and the pursuit of happiness. If each one of us is useful, each of us will be productive and our family will be stronger. Being useful is a very broad concept. It's about much more than making money or being the smartest guy in the room. Business success and intellect are important, but being useful is also about being honest, taking care of customers, inspiring children to learn in school or designing someone's dream home. I learned an important lesson from a friend named Charlie. You can be an inspiration to countless numbers simply with a radiant smile and a "can do" attitude.

The Lucases are far from perfect as a family. We are all flawed as individuals, too. It really irritates me when people tell me how wonderful my family is and then woefully say, "if only you understood my situation," as if to excuse their own passive acceptance of their circumstances. Making any family function well takes determined resolve and serious compromise, and there are occasions when no amount of resolve will make a family functional. What may differentiate my family somewhat is that, as a group, we focus on the values that we think should drive the future management of our family enterprise. We talk about our family's shared heritage—a heritage built on "pluck," persistence, personal flint, and private Quaker faith (plus a few other religions)—and our individuality. We also discuss our tolerance for entrepreneurial risk taking, our expectations for earned income, our desire for investment income, and our long-term goals for the future, as individuals, as nuclear families, as the Lucas family, and as descendents of E. A. Stuart. The overriding question in all these discussions is, How do we take measured and educated risks, with the potential benefit of growing our human capital over multiple generations? Family is a work in progress; it always will be. To Joe Mansueto's point in his Foreword, if we manage the work successfully, we will have true wealth, not just money.

We Are Stewards, Not Owners, of Our Wealth

As the Lucas family wrestles with the work of strategic wealth management, several things have happened.

We have begun to see ourselves not as owners of our wealth, but as stewards of it. We spoke of the drifting apart of various branches of the Stuart family after Carnation's sale and agreed we didn't want our family to fracture further. So we decided to reverse the splintering of the Lucas family assets and, together, manage our inherited wealth so that the bulk of it is passed on to future generations, along with the skills and governance to manage it wisely.

We decided to base future wealth management decisions and strategies on core family and individual values. Why focus on values first? Values help to define family purpose and to construct a framework for establishing your wealth management priorities.

We realized it was critical to foster family harmony, strong communications, and wealth management leadership. Wealth management and wealth creation are difficult, distinct tasks. They require high-order management and leadership competencies, whether the preponderance of your assets are concentrated in one family business or diversified in a portfolio of financial assets. We recognized that effective governance was critical to the successful long-term management of our family's assets, and you will also.

Taking Control for the First Time

As a result of our discussions, my family and I pulled our family trusts out of the Midwestern bank that had managed them for years. In an ironic twist, however, the bank didn't try to retaliate for this move or hold a grudge against our family. Instead, the bank hired me in 2001 to manage its high-net-worth business and to implement for its clients many of the strategic wealth management practices and approaches that my family and I decided to put in place.

The decision my family and I made to replace our existing trustee and to take proactive control of our family's wealth management activities had profoundly powerful effects that I want to share with you throughout the book. You will also learn how to enhance your own financial and family successes, given your own circumstances and objectives.

The Power and Purpose of Entrepreneurial Stewardship

Successful business owners wake up every day thinking, "How can I serve my customers better?" They have a mind-set of continuous improvement. They know that loyalty goes only so far and that if they don't get better their competition will. They also know the satisfaction that comes from being useful to others.

I will show that the math of wealth management requires you to re-create the wealth in each generation if you want to keep it. But the core concept behind entrepreneurial stewardship is about building human capital in your family. With the passage of time and generations, many people worry that wealth can be demotivating. A culture of entrepreneurial stewardship inspires people to lead fulfilling and productive lives, and its spirit can give families a sense of purpose and shared identity that transcends the family business. It's more rewarding than growing investment portfolios. It's more flexible than a family company. It's more effective than family philanthropy.

Our family has teachers, doctors, and clinicians who express a spirit of entrepreneurship and service in their work. You might have scientists, politicians, philanthropists, environmental advocates, or artists in yours. In a world of constant change, entrepreneurial stewardship is the best way to preserve common family purpose while helping each individual family member to flourish.

Philanthropy Has Emerged as a Shared Interest Among Many Family Members

Besides strengthening our bottom-line financial results, improved family communication and financial coordination has yielded other benefits. As our extended family has reconnected in recent years, we've rediscovered much about the wonderful Stuart family legacy and have come to appreciate our common family roots.

We found that many of us share a common interest in philanthropy. E. A. Stuart first set up a foundation back in 1937, and additional foundations have been established by virtually every generation of Stuarts since then. Today, these foundations focus the attention of family members on the needs of disadvantaged children, the elderly, at-risk urban youth, schools, and other social issues. Stuart family members quietly give away millions each year in their capacities as foundation trustees and directors. Following in E. A. Stuart's footsteps, many of us also give substantial sums to charity from our own pockets and spend countless hours working with nonprofit organizations both large and small. Some of these causes are well known and prestigious, whereas others are small and support some of society's neediest people. I'll have much more to say about philanthropy as a family bonding agent and component of wealth management in subsequent chapters.

Closer Family Ties

Since the members of my immediate family today coordinate our wealth management activities, it has brought my siblings, parents, and me closer together emotionally than in years past. You should know that growing diversified wealth is not easy. It requires cutting-edge investment and/or business knowledge, a competitive spirit, shared vision, education, and effective governance. It also requires a commitment to communicating openly, honestly, and respectfully with other family members—even when you don't always agree with them. In the Lucas clan today, that's not always easy to do. As our family continues to grow, we must each consider the concerns and interests of all family members in setting wealth management goals and making other critical wealth management decisions.

The Value of Family Lore

Growing up, my siblings and I were raised on stories of E. A. Stuart's persistence in the face of repeated setbacks in starting the Carnation Company. Those lessons resonate in us to this day, and I hope that our family stories make this discussion of wealth management less academic and more tangible to you, regardless of your financial or familial situation.

There's a delivery drop box from one of E. A.'s notable business failures—a dry goods business that flopped before he founded Carnation—that we keep in the kitchen of our Cape Cod summer house. We keep this drop box around for an important and symbolic reason: to emphasize that wealth isn't to be taken for granted and isn't easily attained. "You may have inherited wealth, but in this family you are expected to work hard" is the message my siblings and I got from our parents growing up.

The story of how E. A. Stuart ran Carnation in its early years contains important lessons—not just for running a business, but also for managing the wealth that a business creates. Many of his ideas, in fact, form the core principles espoused in this book:

- **Consistent profits are critical to successful growth.** In its 86 years as an independent company, through two world wars and the Great Depression, Carnation lost money in only three years. The keys to this remarkable track record were prudent diversification, modest leverage, recurring cash flow, empowerment of people, and careful measurement of results.
- **Take measured and informed risks.** The entrepreneurial risks he took and his well-honed intuition were always grounded in his deep knowledge of his business.
- **Align your interests with customers and suppliers.** E. A. Stuart was always looking to partner with people, not to gain the upper hand as an adversary.

- **Conserve your wealth.** He worked hard and was frugal. To this day, my mother takes real pride in describing her family as "understated people."
- **Be useful.** This was E. A. Stuart's ultimate measure of success.

How My Dad Taught Me the Value of Money

A quick story from my childhood illustrates just how large a role prudence and "financial modesty" played in my family's household when I was growing up. In 1965, when my family and I moved back to the U.S. following a three-year job stint for my father in Europe, Dad bought a brand-new red Plymouth Valiant. Over the next 17 years, as he rose through job ranks at Carnation, ultimately to become President of the International Division, this car remained his preferred form of transportation for virtually all business and family activities. Even when the presidents of overseas divisions turned up in Los Angeles to meet with Dad to conduct business, they always drove to company dinners not in some shiny Lincoln Continental or Cadillac, but in my father's red Valiant!

My father so loved this Valiant that for its 25th anniversary in 1990, we bought a vanity license plate for it that read, "65 JUNK." When 65 JUNK finally gave up the ghost, my father pulled the Mercedes that my grandmother had bequeathed him years before out of storage and began to drive it. By then, it was only 20 years old. "Still has many years of useful service in it," he told us.

The lesson my father taught us by keeping that less-than-fashionable Plymouth Valiant around for so long was clear: "Image isn't everything. Don't squander your assets. Preserve your wealth and use it for worthwhile pursuits no matter how much of it you might have." The message he sent to his division presidents was equally clear: "Cost control is important, and I lead by example."

A Book About Strategic Wealth Management

Today, my family's value system regarding money is based both on personal prudence and on an aggressive and shrewd approach to the long-term strategic stewardship and growth of wealth. You'll read a lot about these values—and others—throughout the pages of this book.

But I don't assume that my values are your values. I've learned many lessons about wealth management, as a member of a wealthy family, as an industry professional advising others, and in my years of teaching the Private Wealth Management program at University of Chicago Booth School of Business. One of the most important things I've learned is that each individual and each family has its own values and unique circumstances relating to managing wealth. This book discusses many roads to effective wealth management, not just the ones used by my family. You can explore the options and then decide which ones are right for you.

This book deals with how you can manage your wealth, be it for your lifetime or for multiple generations, using proven wealth management principles to do so. What I say here is directed to anyone concerned about wealth creation, wealth management, family business, retirement planning, and multigenerational estate management. The book will be of value to wealth industry professionals who are interested in providing their clients with fresh investment insights. It will also help upwardly affluent professionals and successful entrepreneurs who are interested in adopting a strategic, focused, and disciplined approach to growing and diversifying their financial assets.

With an insider's perspective, I wrote this book to share the lessons that my family and I have learned, and hopefully to spare you from some of our mistakes. Most of these lessons apply whether you are worth a few hundred thousand dollars or a few hundred million.

As you turn to Chapter 1, "Protecting and Growing Your Wealth," remember this: Wealth management isn't just about money. It's also about people, relationships, values, doing well by doing good, and, of course, family. Enjoy this book for the tools and insights it provides you. Use it as a guide to more strategic and insightful stewardship of your personal and family wealth and to the achievement of a more fulfilling life. Wealth is a gift you should safeguard, nurture, and share productively with others. This book will show you how.

Stuart Lucas

August 2012

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Protecting and Growing Your Wealth

"Solve your problems. Don't let them lick you."

—E. A. Stuart

What can an individual like you and families like yours do to protect and grow your wealth, share it with others, enjoy financial security, and build lasting personal and family legacies?

Over the past 30 years, I have learned that effective wealth management has little to do with how much money you have or how you accumulated it. Effective wealth management is much more about how well you manage than it is about how much you manage. The hard lessons that I've learned as a financial industry insider and from managing substantial wealth for my family and other wealthy families are the focus of this book. These lessons are applicable to anyone willing to meet the challenge of managing wealth.

Since the first edition of *Wealth,* I've also had the opportunity to design and teach an executive education program for wealth owners at the University of Chicago Booth School of Business. Over the past five years, more than 400 people from around the world, with wealth from millions to billions, have taken this four-day course. They have generously shared their wisdom in the classroom and in private with me. Many are first-generation entrepreneurs who often attend with their spouses, and sometimes their grown children, laying the groundwork for a multigenerational family legacy. Others are business owners who want to manage their excess cash flow more productively, or who've just sold and need to navigate the labyrinth of wealth management. Every class has a group of second-, third-, and fourth-generation inheritors (one Asian participant claimed more than 50 generations, and another Latin American family has lived continuously in the New World since before Cortez landed in 1519). These people have a different, equally valid, and often more informed perspective on multigenerational wealth than do the first-generation entrepreneurs. It gets rather complicated to manage a family business, financial assets, and multiple generations when your family numbers more than 100 people!

By sharing the lessons I've learned firsthand and from the wisdom of other wealth owners, and using real-life illustrations, I'm confident you can avoid many of the pitfalls inherent in managing your personal wealth, whether you're a business-owning entrepreneur, in the aftermath of a liquidity event, or a fourth-generation heir.

Wealth management is about more than deploying capital effectively, though that is an important part. Money, business, family, and community are invariably bound together. People pay taxes, save, spend, support philanthropic causes, and transfer wealth to their heirs. Successful wealth management involves the integrated and effective management of all these components.

Transitions

Some people build their wealth by saving money a little bit each month and managing it with the goal of having financial security in retirement. Even after years of accumulating financial assets, working with advisors, and experiencing the volatility of financial markets, they are still uncomfortable with how their assets are managed and are looking for better ways to achieve their goals.

Others focus on building equity capital in their business for years, decades, even generations. As the business matures, excess cash flow might be used to diversify into financial and other assets, requiring the development of new financial and investment skills. Most business owners are ill-prepared to deal with the abrupt and often stressful circumstances associated with managing their accumulated savings in the wake of selling their business. In the aftermath, their wealth takes on a completely new character.

The same can be said for those who work hard at their careers for many years and retire with a pension that they are now responsible for managing, or those who receive assets as a result of divorce or loss of a spouse. One of the biggest sudden and high-stress circumstances for coming into wealth is the death of a parent. Over the next 50 years, the United States will see the greatest transfer of wealth in its history. Boston College researchers John J. Havens and Paul G. Schervish estimate that, over this period, total bequests to heirs will total more than $41 trillion.[1] In many of these circumstances, people will not be prepared to take on the responsibility of their new wealth, and the event itself will often come as a surprise.

Building and conserving wealth takes time, and it demands considered action. The key is to not do something prematurely that results in a significant loss of capital. For that reason, resist the impulse to act quickly or to retain outside wealth advisors before you are ready to act. Do your homework first and plan ahead. Carefully consider how you will continue to manage and grow your wealth and help your family to flourish, whether you are most concerned about managing in your golden years or you want to create and/or manage a multigenerational legacy of strong human and economic capital.

How the Wealth Management Industry Works

Why is it important to plan before engaging wealth management advisors to manage your assets? You need knowledge to protect your interests. Unless you are a proactive, thoughtful, and informed client, the structure of the wealth management industry today actually works against your interests in three ways:

1. The wealth management goals of clients and their financial advisors can easily diverge. When conflicts of interest arise, advisors might put their own interests ahead of those of their clients.

2. Advisors are unlikely to fully understand or appreciate your business, personal, and family dynamics. These dynamics are key drivers of wealth management priorities, goals, risk factors, and strategies in families, and they influence many business and investment decisions—frequently behind the scenes.

3. Very few wealth management professionals have enough breadth of skill and experience to operate across multiple disciplines or to anticipate how advice offered by one expert can potentially affect that offered by another. The advice of one advisor should, ideally, complement and reinforce the value of another advisor's input. But the siloed nature of professional fields such as estate and tax law, financial planning, investment management, and banking often works against this desired outcome.

Wealth management firms that are waiting to make money (from your money) include brokers, mutual fund companies, life insurers, money managers and hedge funds, law firms, banks, independent financial planners, accounting firms, and multifamily offices. The organizational culture in most firms focuses on finding a balance between getting acceptable results for the client and achieving the firms' profit goals. As with any market-driven business, the financial rewards and recognition that wealth management practitioners enjoy are based on the amount of business they bring in the door. A premium is placed on generating revenue. It's easy to measure and is tied directly to firm profitability. But larger revenues and bigger profits don't always mean better service.

By contrast, it's not easy to measure the added value that a wealth management firm or advisor actually generates for a client. Thus, clients are often left in the position of having to trust their advisors without an accurate yardstick to measure their effectiveness. This is a big reason why numerous studies of the wealth management industry show a high level of customer dissatisfaction.

This state of affairs hasn't been in the long-term interests of either party. Fortunately, the problems are not insurmountable. That's why America's wealth management industry is in a state of dynamic transition, in which old business models are competing with new ones in a struggle between service and profit. No one knows which will be the winner. There is no better system than a competitive marketplace to resolve industry problems, but the process is messy and clients can get hurt. For that reason, I say: "Buyer beware!" and "Keep reading this book!"

Classic Approach to Wealth Management

Many people rush to retain wealth management advisors in whom they desire to place their trust. Clients are busy, and most are anxious to have professional oversight in place. They either look to a trusted advisor who has helped them before (maybe with issues unrelated to current wealth management challenges) or respond to inquiries from enterprising advisors who identify them as new business prospects. In either case, people often choose one firm immediately or decide to have multiple firms compete for their business before they really know what they want or how to assess accurately the characteristics and quality of each firm's offering. During the course of the selection process, prospective advisors are asked to explain the strengths of their firm and their own background and to describe how they would manage the assets if the prospective client chose them. The prospective client tries to absorb this information with limited relevant experience and typically chooses the most attractive-sounding sales pitch without a thorough understanding of what they want to achieve or the likelihood of doing so.

Sidebar 1.1: Learning the Language of Wealth Management

Many people's experience with wealth management advisors is minimal at best. Making matters worse, the language of the wealth management industry is often mysterious and intimidating.

I am regularly reminded (usually by one of my children) of just how much a "language barrier" can incite feelings of misgiving and uncertainty. One notable reminder of this barrier came in the form of Pokémon, the hugely successful Japanese trading card game based on mythical creatures pitted against one another in combat. Pokémon is a game at which my then eight-year-old son excelled, but at which I was at best an outmatched opponent. The complex world of Pokémon is filled with hundreds of creatures—some that evolve into others—with myriad powers and weaknesses and all with unpronounceable names. Besides trading cards, there are also stuffed animals, television shows, how-to books, and Pokémon

T-shirts. My son was both an expert at Pokémon and a supremely confident Pokémon salesman. Here's a typical exchange that we might have had in the course of playing a round of Pokémon:

Son: Daddy, why don't you battle this Cyndaquil against my Feraligatr? Cyndaquil is really cool; he has singe attack and an HP of 50!

Dad: What attacks does Alligator have?

Son: Not alligator, Daddy, Feraligatr! He has slash attack.

Dad: Oh, okay. Well, can I use slash attack instead of singe attack with my Cindyquill?

Son: No, Dad. You have to play by the rules. You should know that...

As you can see, this conversation is already a slippery slope. After five minutes of talking with my son about the arcane details of Pokémon, my head was spinning. I couldn't remember what HP is, let alone whether 50 is good or bad. Singe attack didn't mean anything more to me than slash attack. As I played the game, I never quite knew when the rules changed, and even if I did, my facility with the vocabulary of Pokémon was too rudimentary to argue my case. (My son, of course, knew this.) In addition, I hadn't read the small print at the bottom of the Cyndaquil trading card, which states that its weakness is slash attack. After my inevitable loss, I didn't have to ponder very long whether my son had systematically memorized all the small print this game has to offer, with the intention of clobbering me every time we engaged in battle.

Although my son is now 15 and has moved on from Pokémon to other games of wit, power, and deception, the story still seems to resonate.

When faced with managing their wealth, many individuals find themselves in situations similar to those I faced when I played Pokémon with my son. They must operate in alien territory, trying to understand the parameters of an unfamiliar game while being outmaneuvered by complex rules and a vocabulary they don't understand.

After the new client chooses an advisor, both client and advisor are limited to solutions that the advisor can provide, whether or not they are advantageous to the client. Because most private wealth advisors don't generate revenue from a client until they have sold one or more products, and because many clients want the security of knowing that their assets have been invested, there's often an unspoken urgency on both parties' parts to consummate investment arrangements and to lock the client into specific solutions, often with long-term consequences.

When they rush to action, most clients have not thought deeply about their financial, personal, or family goals, how to realistically achieve them, or their comfort with financial risk. So their financial advisors end up driving the agenda. Most advisors inquire about the client's financial situation and learn something about his or her goals, family situation, and personality. This classic approach leaves little incentive for advisors to explain the pros and cons of all the financial options available, especially low-cost, high-value ones. After interviewing a client, the advisor interprets the client's expression of need and selects the firm's available products that most closely match that interpretation, regardless of whether they are optimal for the client. For example, a standard asset allocation is constructed, it is divided by major category or asset class—stocks, bonds, cash, private equity, hedge funds, real estate—and a target allocation is assigned to each category so that the total equals 100%. Then the advisor reviews his firm's stable of available investment managers and recommends a subset that represents each asset class. The client then reviews the list, approves the recommendations, and invests the target amounts.

Within a month or two, and sometimes faster, the client's strategy is set, the assets are fully invested, and the revenues are flowing to the advisor's firm. From here on out, the advisor meets periodically with the client to review the performance of the portfolio, to offer suggestions for improvement, and to make any agreed-upon changes. This classic approach is standard across the industry, and it happens time after time.

Strategic Wealth Management of Your Family Enterprise

You can see that the classic approach equates wealth management with investing. This book focuses on a new way to structure your wealth management affairs. I call it "strategic wealth management." Strategic wealth management is a holistic approach to wealth management that focuses on your entire family enterprise. At its heart, family enterprise is about human capital, not just money. The complete enterprise integrates your family purpose with your business, financial assets, careers, estate plans, and other aspects of your personal and family circumstances. It explores all of your strategic options and puts you in the driver's seat while showing you how to employ your advisors to greatest effect. Your values, your skills and resources, and how you relate to your business, career, and family are at the core of the strategic wealth management approach and are key elements of what I call the "Strategic Wealth Management Framework."

Figure 1.1 diagrams a new Strategic Wealth Management Framework, updated from the first edition of *Wealth.* This new framework is based on hundreds of detailed interactions I've had with other wealth owners since this book was first published. I've learned a lot from them and I'm grateful for the wisdom they've shared. Their insights have broadened my thinking and given me increased confidence that wealth effectively managed is proactively managed. The Strategic Wealth Management Framework is now more action oriented than its predecessor, highlighting the key value drivers for success. Effective governance of your key value drivers—family purpose, your economic engine, and your management of leakages—is the heart of the framework and the lifeblood of your family enterprise.

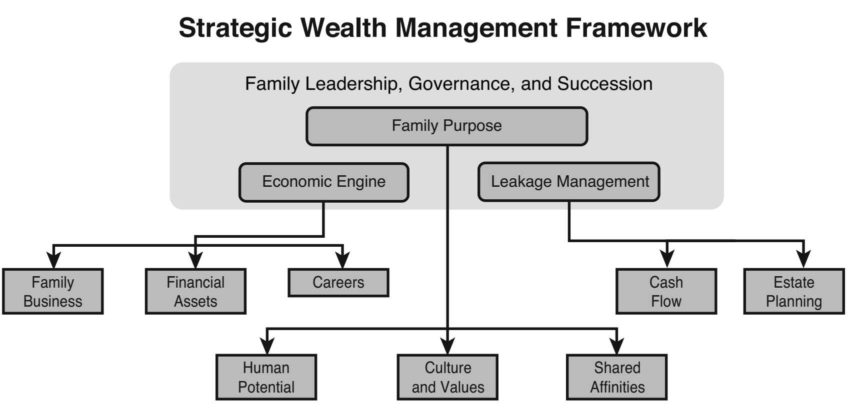

Figure 1.1 Use the new Strategic Wealth Management Framework to create a fully integrated plan that meets your objectives.[2]

Using this framework requires more time and effort to implement than the classic model. It is a more comprehensive, systematic approach designed to help you manage your wealth according to your personal and family goals, whether for your lifetime, or for multiple generations. If you work with this framework, you will spark greater focus for your family and will generate better performance from your advisors. Fortunately, there are many surprisingly simple elements of managing wealth, especially financial assets, effectively. Many are even simpler than the classic approach implies. I will highlight these simple, pragmatic, responsible solutions throughout the book. Take them to heart, especially if your core interests lie elsewhere than investing, tax, or complex estate planning.

Figure 1.1 shows that flourishing family enterprises require a clear and shared family purpose, a strong economic engine, and effective management of leakages. Sometimes these key value drivers work in harmony, but conflicts among them regularly arise and must be resolved. If your family is executing well in all three areas, you can make business decisions for the success of the business, invest financial assets prudently for long-term appreciation, and support family members to realize their individual potential while strengthening family ties. In well-managed families, success and stability in any one sphere influence and strengthen the other spheres and the whole system, creating a virtuous circle.

For the virtuous circle to prevail, effective leadership and governance are necessary, within and across the three key value drivers. Governance structures must be aligned, values and rules of engagement must be shared and understood, and leaders must be credible and empowered.

- **Family purpose.** The family's leadership, operating within the governance structure, is responsible for shaping, communicating, and advancing the family's purpose. Family purpose is supported by three commitments:
    - *Maximize the human potential of each family member.* When each individual is encouraged to flourish and be productive your family benefits, regardless of the way in which each individual meets his or her potential.
    - *Adapt and evolve the family's culture and values over time.* In an ever-changing context that is our world today, a stagnant

family culture and value set will likely become irrelevant and be ignored.

- *Identify and invest in shared affinities.* What brings family members together with purpose or fun? What builds a sense of shared identity and purpose? Invest in these affinities just like you do your economic engine.

In catalyzing connections and common identity beyond your family's economic ties, a shared purpose provides the platform for stronger interpersonal relationships and more effective decision making. The strength and value of shared family purpose become particularly evident during times of transition: of leadership, of generational ownership, and during the complex transition from business-owning family to financial family.

- **Economic engine.** Your lifestyle is fundamentally tied to the strength of your economic engine. In the wealthiest families, this link might seem trite—but even in these families, eventually reality bites.

  The math is clear, though not widely understood. Your family's economic engine—businesses and/or financial assets—must generate annual returns of at least 10% just to cover the combined weight of taxes, fees, inflation, (modest) distributions, and the "law of compounding children" (the growth in the number of family members from one generation to the next). Over a generation or two, only exceptional businesses and investment portfolios generate returns at this level. The strength of your family's overall economic engine depends on the robustness of each of the following: your business, the performance of your financial assets, and your family members' careers.

  - *Your family business.* Businesses are typically the primary engine of wealth creation. Most businesses start out undiversified, illiquid, and subject to powerful operational, economic, and competitive factors that can lead to wealth creation and, just as rapidly, wealth destruction. If your fledgling business survives to maturity, your family will face new challenges. Mature family enterprises control businesses that generate stable excess cash flow—although they still entail considerable risk. Families in this enviable situation face additional challenges. How do you maintain a family culture of entrepreneurship as the wealth grows? What should be your family's continuing operational involvement in the business? How should your operational involvement affect your governance structure? How do you diversify if you don't want to sell your business? How do the cash flow requirements of the business, financial assets, and family members relate to each other?

Most families eventually choose to sell the core family business. For any number of reasons—perceived risk in the business, lack of family business leadership, animosity within the family, inadequate returns—a family might determine that the benefits of continuing to own the business are insufficient relative to the value achievable from selling. You want to maximize the probability that your family will control the disposition of your core asset, rather than having a decision forced upon you by externalities. For the optimal outcome, you want to evaluate the decision to hold or sell within the context of your family enterprise as a whole. What would be your net-net result, after the sale causes you to realize what might be decades or generations of deferred capital gain on your company shares? What will you do with the cash? Where will you reinvest the proceeds not earmarked for spending? Are you prepared—organizationally, culturally, and in terms of financial infrastructure—to be a financial family? The transition from a business-owning family to a financial family is a radical and risky transformation of the family enterprise. You want to be prepared.

- *Financial assets.* Excess cash flow generated by your business and salary can be used to diversify into financial assets. Effective conservation and management of your financial assets is crucial to the functioning of your family enterprise, especially as they become substantial asset pools in their own right. Well-managed financial assets bring your family greater economic security by diversifying the family enterprise without having to sell the core business. They also give the family financial management experience that grows exponentially in value when there is a liquidity event. On the other hand, I've seen poorly managed financial assets, sometimes by just one individual, bring unanticipated liabilities to bear on entire families (for example, when a cousin uses shares in the family business to collateralize a risky loan).

Some families distribute excess cash flow to each family member, leaving it up to individual family members to manage their capital as they see fit. Other families make a concerted effort to commingle financial assets, develop a common investment strategy, and retain highly experienced investment professionals.

Considerable benefits come from managing financial assets with scale and focus, especially if your collective assets exceed $100 million or more. First and most important, you can attract better investment talent, specifically a chief investment officer (CIO), with a single large asset pool than with a series of much smaller, independently managed pools. A CIO is a professional investor—not a client service representative or product salesperson—responsible for delivering investment performance and integrating that effort with the strategy for the entire family enterprise. Second, your single, larger pool of capital will have access to more desirable investment opportunities, which often come with higher minimum investment requirements and lower management fees. Third, commingling assets allows your family to share the administration of estate planning and investment management, simplifying tasks and lowering administrative costs. Finally, with a commingled investment strategy, family members are mutually accountable. To make the strategy work, each family member must control his or her financial affairs within guidelines that are agreed upon through the family governance process. Although to some this all might feel constraining, the structure and discipline of pooled investing and leakage management can significantly increase your family's economic security, including the long-term security of your core business.

- *Careers.* Careers generate additional income and reduce your family's overall economic risk profile because they diversify family members' sources of cash flow. Careers carry a cultural benefit to your family, too. Over generations, wealthy families risk creating a culture in which family members are always valued customers but do not benefit from the discipline of having customers themselves. A culture of setting stretch goals, of prudent risk taking, of service to customers and community, and of having to make reasonable sacrifices in the pursuit of those goals is healthy. Again, we see the potential for a virtuous circle: The less each family member depends on the family's wealth for his or her lifestyle, the more risk you can collectively afford to take, and the more likely the family enterprise will flourish for generations to come.

- **Leakage management.** Think of the economic engine as having leaks—dividend or distribution payments, expenses, taxes, and inflation, to name a few. Leakages are an inevitable part of any family enterprise, and they are much more within the family's control than the value of a business or an investment portfolio. Over years and decades, leakages profoundly affect your family's wealth, but their importance to the long-term vitality of your family is often poorly understood. The larger and less well-managed your leakages are, the greater the risk to the family enterprise and the more likely it won't stand the test of time.

  You can divide family leakage management into two areas. The first area is cash flow management. How much is distributed to family members and spent each year? What are family operating expenses above and beyond those of the business? How much does your family pay in taxes annually? The second area is estate planning, including governance, control, succession planning, and tax minimization. How much of your family wealth will be transferred to government coffers upon the death of family members? Are estate plans structured to help protect the family's assets from unwanted outside interference?

  Good leakage management can mean the difference between maintaining control of your family business and leaving the fate of your family enterprise to chance, and seemingly small changes in the rate of leakage can have large consequences over ten, twenty, or fifty years.

- **Building a virtuous circle.** People wonder why family enterprises don't last. A healthy economic engine is necessary, but insufficient. For long-term vitality, you must manage your entire family enterprise as an integrated whole. Well-managed family enterprises are stable and strong with good governance, clear family purpose, diversified assets, and controlled leakages. Operating in this context, you can make prudent long-term investment decisions for your core family business, determine the most productive level of family involvement in the business, and control its destiny. Your family's financial assets, professionally managed to realize the benefits of scale and focus, are key contributors to your family's continuing economic vitality. Family members feel a strong positive connection to your family enterprise and are encouraged to thrive and contribute to an evolving, forward-looking family culture. When you build this virtuous circle, you are stewarding your good fortune and cultivating your family's valuable business, human, and financial resources. In doing so, you serve the family enterprise as a whole, as well as each family member.

The Eight Principles

The dynamism of today's wealth management industry, coupled with ever-changing business pressures and the complexity of family dynamics, can make managing a family enterprise difficult, even with the Strategic Wealth Management Framework. So, I devised Eight Principles of Strategic Wealth Management to help my family and my readers by bringing greater clarity and precision to our actions and activities. I use these eight principles as guideposts to keep me focused on the things that are most important when it comes to implementing a family enterprise strategy. When decisions get complicated, the Eight Principles help me narrow my choices while maximizing the impact of each decision I make. They can do the same for you. In the next chapter, I will discuss the Eight Principles in detail.

I know that the Strategic Wealth Management Framework and the Eight Principles of Strategic Wealth Management work because they have worked very well for my family and for many others. By using them,

- You'll make sound wealth management decisions based on purposeful reflection, planning, and action.
- You'll select advisors whose skills and experience best match your financial objectives and family enterprise strategy.
- You'll make sound capital allocation decisions that are closely aligned with your business outlook, investment skills, interests, and risk tolerance.
- You'll integrate cash flow, tax management, and estate planning with your asset growth strategies.
- For those with a multigenerational perspective, you'll build your sense of shared family purpose and a culture to enable each individual to flourish.

By embracing the Strategic Wealth Management Framework and the Eight Principles of Strategic Wealth Management, you'll be able to project your values and ambitions (and those of your family) outward into the external environment to achieve specific and concrete goals. When your strategy is a success, you create a legacy that improves your satisfaction and significance, and that benefits your family and society.

The Family as a Cultural System

No two families are alike. All families, wealthy or not, are complex, dynamic organisms that are forever-changing cultural systems. The culture of a family consists of the beliefs, values, attitudes, norms, and behaviors of its members. Each family's history affects its current culture. Individual family members influence one another in countless, complex ways. Numerous external forces influence the life, identity, and norms of a family as well. Marriages bring "outsiders" into a family, and death and divorce can shatter families and shift lines of power and influence. The extended families of spouses who marry into a family exert their influence too, bringing with them new issues of culture, heritage, business success, family dysfunction, and social prominence.

The very presence of wealth colors the dynamics in any family. Money can be tremendously empowering and can afford its owners extraordinary opportunities. At the same time, money can complicate family relationships, foster resentment, and create dependency. At the extreme, poorly managed wealth can lead to disenfranchisement, degeneracy, and even corruption.

I believe that wealthy parents—like all parents—need to be intentional about instilling values of accountability and responsibility in their children when it comes to the use of money. Indeed, doing so can be critical to the family's long-term survival! Many wealthy parents indulge their children financially. In so doing, they often foster economic dependency and create a generation of children that feels entitled to the benefits of wealth but that is ill-prepared to manage the responsibilities that wealth entails. Such children often become reliant on their parents for their lifestyles and often lack the discipline, education or even experience to use money wisely. It's no wonder that some people believe that passing wealth from one generation to the next is doing their heirs and society a disservice.

Not surprisingly, financial dependency can affect a family in significant ways. Just how do you go about raising a generation to be empowered by its wealth, not filled with a sense of overentitlement because of it? I don't know of a single wealthy parent who doesn't worry about this issue a great deal.

That's one more reason why wealth management is about so much more than money. True family wealth comes not from money but from maximizing each individual's human capital and by nurturing a culture of collective goodwill and personal responsibility within the family. Doing this can ensure the health of families (and their money) for multiple generations. The failure to do it leads to family dysfunction and the rapid loss of wealth.

Taking Control of the Wealth Management Process

Using the Strategic Wealth Management Framework requires leadership. Leadership is necessary to define and reinforce your family purpose, govern your business, and manage your family's leakages. You must accept personal accountability for managing your wealth, regardless of whether you want to manage simply and conservatively or with focus and risk. It doesn't matter whether your goal is to build the next Rockefeller dynasty, launch a new start-up business, save for retirement, or hand over day-to-day responsibilities for wealth management to an advisor who has earned the moniker "trusted." In all cases, you, as the wealth owner, must take personal charge of your wealth management by assuming a role I refer to throughout the book as the "Wealth Strategist."

Sometimes the Wealth Strategist is an individual. Sometimes several, or better yet, all adult family members work as a team to play the role. Typically, a first-generation wealth creator takes on the role himself or herself. In a multigenerational context, either model can operate successfully. However, if you still have a family business, business leadership is often separated from the Wealth Strategist role. The Wealth Strategist's role is governance and succession planning for the entire family enterprise, of which the business is one critical component. Managing a complex multigenerational family and managing a successful business are just too much for one person to manage effectively, and the required skills are different.

In the multigenerational context, just as it is important for business leadership and financial managers to be accountable to the owners, it is important for Wealth Strategists to serve at the pleasure of the family. Autocratic leadership is a characteristic of many successful entrepreneurs, but as an American family governance structure it tends to be fundamentally unstable, even when the position is earned through merit and sanctioned by the previous generation! One of the big challenges for second-generation leaders of family enterprises is in shifting the culture from autocracy to a more democratic form of family governance, even as your family business might continue to need strong, autocratic executive leadership. As families plan succession from one generation to the next, it's important to think about the characteristics required to be a successful leader in the next generation, not just the preceding one. Business-owning families have another transition that they often have to struggle through: shifting the family's involvement from business leadership and governance to business governance that relies on nonfamily professional senior management.

Successful Wealth Strategists have a skillful hand in leading their families through these transitions. For those with substantial wealth and a multigenerational timeframe, a managed transition of the Wealth Strategist role from one generation to the next is a critical task. In turn, my great-grandfather, my grandfather, and then my father played the role of Wealth Strategist. Today, I share the Wealth Strategist role with my brothers William and John and our sister, Nori. My sister-in-law, Melissa, my wife, Susan, and I also lead Wealth Strategist Partners, serving as Chief Investment Officer to our family and a handful of others. As a rule, our family believes in gradual generational transitions, not as a delaying tactic by the older generation to retain power, but to give ourselves time to diligently work through the inevitable issues that arise. Time has been our ally in working out complex family and financial dynamics. I hope it can be yours too.

You and your family stand to benefit greatly from having designated Wealth Strategists in place to work closely with advisors and family business leaders. As a chief investment officer to a handful of wealthy families and a teacher of wealth management, I know that the relationships I've built with designated Wealth Strategists from other families over the years make wealth management activities a lot easier and more efficient for everybody. If I'm able to work with a designated Wealth Strategist, we can optimize our working relationship in numerous ways. We use our time more efficiently, we make better investment decisions during times of stress, and our decisions are based on a clearly understood set of operating principles and investment goals. As an educated client, you'll delegate responsibility more effectively, and you will distinguish confidently and accurately between good and mediocre performance.

The Nature of the Wealth Strategist's Role

Wealth Strategists play the critical role in developing and executing a family's wealth management strategy. They work closely with their family to define plans and goals for the family enterprise and then oversee implementation, coordinating the involvement of family members, business executives, and professional financial advisors as needs require. The Wealth Strategists' main governance functions are to manage the key value drivers of family purpose, the economic engine, and leakage management, and to integrate the advice and activities of various professional advisors with the overall wealth management strategy and with the dynamics and priorities of the family. Wealth Strategists in multigenerational families must also take responsibility for leading smooth succession transitions. Without careful planning and effective execution, entropy will pull at your family, just as it has mine. The family will fragment, even when there is no animosity among family members. Without the collective will to fight entropy, as your family grows and matures, the allure of money plus individual autonomy is just too great. The cost becomes apparent only later. Believe me, I've seen it firsthand.

Becoming a Wealth Strategist doesn't require detailed knowledge of business management, investment theory, estate law, or the tax code. However, it does require the following:

- Patience and a long-term perspective
- The ability to foster good communication among family members
- Accurate assessment of your own skills, those of family members, and those of prospective advisors
- An informed layperson's understanding of how the wealth industry works
- Reasonable financial and managerial discipline

I'll have much more to say later in this book about the critical role of the Wealth Strategist. Suffice it to say for now that the Wealth Strategist is in fact the leadership within your family, and it is the job of this individual or team to ensure effective wealth management over time.

Conclusion

This chapter introduced a new Strategic Wealth Management Framework and explained why it's so important for you, the wealth owner, to grasp the reins of control when it comes to implementation. Exercising strong leadership as a Wealth Strategist while following the Framework significantly enhances the productivity of your advisors, and puts you on a track to fully execute your family enterprise strategy and realize your wealth management goals.

Let's go on now to Chapter 2, "Eight Principles of Strategic Wealth Management," where I talk in depth about the principles that are central to the effective management of wealth.

Chapter 1: Issues to Discuss with Your Family

1. Do you find the subject of wealth management intimidating? If so, why?

2. Does your family communicate well about business and money? How might communication be improved?

3. How would you describe the "culture" of your family? In what ways do your family's beliefs, values, attitudes, and norms shape behavior when it comes to risk, growth, spending, and saving? Is there "a presumption of good will" among its members? How can you repair distrust if it exists?

4. Has your family taken time to articulate its "purpose" and how that purpose should drive future wealth management planning efforts?

5. Is "doing your homework" and planning ahead before hiring your wealth management advisors a reasonable approach to take? If not, what forces compel you to act now? What are the long-term costs or advantages of taking your time?

6. Do you have a personal interest in closely managing your finances? If so, how much time are you willing to devote to this activity? If you do not have interest in closely managing your finances, can you structure your wealth management strategy accordingly?

7. Who are the logical Wealth Strategists for your family? Why? What if there isn't a logical choice or a consensus pick?

8. Have you ever hired someone to manage your finances? Was it a positive or negative experience? If it was negative, how can you improve things in the future?

9. Do you know how to assess the relative merits of prospective advisors? How do you know you've assembled the best alternatives to choose among instead of a middling pool of talent? (Hint: Brand alone is not the answer.) After you've hired an advisor, how and when will you know they're doing a good job?

10. What advantages do you see in using the Strategic Wealth Management Framework as a tool in family enterprise planning instead of the classic approach?

Endnotes

1. John Havens, Boston College Center for Wealth and Philanthropy, 2012.
2. The new Strategic Wealth Management Framework was first published in the July/August 2012 issue of *Family Business Magazine,* published by the Family Business Publishing Company, and is reprinted with the permission of the publisher. For more information, go to www.familybusinessmagazine.com.

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