Reg Reform Won't Bring Clients Back to Public Markets

By Charles Lowenhaupt

June 6, 2013

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Speaking at Finra's annual conference in Washington, D.C., last month, Richard Ketchum, the securities industry self-regular's CEO said, "The financial services industry has weathered many challenges in the last few years: a recession, significant frauds, a flash crash. And while we have worked hard to prevent those kinds of events form being repeated, they have had a lasting effect on investors' trust and created a true crisis on confidence in the markets."

So what does Finra propose to do about the financial chicanery and technological glitches that have shaken financial markets in recent years? Impose more regulation. For the world's wealthiest families, however, mere regulatory reform isn't enough.

Mistrustful of financial markets, the world's wealthiest investors are making direct investments in businesses, real estate and tangibles. How can financial-service professionals move the wealthy — American, Latin American, Asian or European — back into the securities fold?

Not by pushing products harder, that's for sure. They would be better off striving to understand the psychological underpinnings of the high-wealth client's preference for direct investments and then taking time to figure out what they mean for the business of managing wealth.

Reasonable Inferences

The first thing that becomes apparent under such scrutiny is that the kinds of investments that appeal to the ultra-rich are easy to understand. They know, whether by experience or by family lore, that businesses prosper by dint of hard work and smart management, not by virtue of exotic due diligence — and not in structures dependent on custody, counterparties, trade execution, issues of segregation and currency fluctuations. As a result, structured products, derivatives and many funds are out. In this milieu, advisors who can recommend companies with solid fundamentals and real value propositions will have an advantage.

The idea is that complexity breeds anxiety, so advisors can make their wealthy clients more comfortable by articulating strategies that are effective and powerful, but simple and transparent.

Direct investments and tangible assets are appealing for another reason: They aren't "valued" day by day. When you're investing in an asset for the long term and it's not publicly traded, market timing is irrelevant. It's easier to be patient — and not get frightened by volatility — when you can't get an asset's up-to-the-minute market value at the touch of a screen.

So an advisor can help wealthy families select stocks of publicly traded companies or money managers who invest in them by focusing on long-term performance and emphasizing the need to ignore price fluctuations and market volatility. In other words, an advisor to such families should channel Warren Buffett by thinking and talking only about the long term.

The Importance of Process

Third, these investors depend on clear process, unambiguous role and well-defines expectations.

Process, above all, provides comfort and creates success. Making process clear and transparent, whether the process in question relates to execution, custody or the articulation of expectations, sends the message that trust is well placed.

Last, an advisor should recognize that direct investments in businesses offer real connections to society. They have to do with real people in ways that complex financial products simply don't. By telling stories about the impact of publicly traded stocks, the advisor can tie investments to communities, so the client feels connected to the world. This connection is particularly important as a family raises its children and strives to transmit its values. After all, showing children how money the money their family invests can help a good business benefit customers, employees and investors alike can be a great way to instill values.

Wealthy families may be able to avoid publicly traded assets altogether by investing directly, perhaps without any help from financial-service providers. Many single-family offices now focus exclusively on such investments — productively and with considerable diversification.

But other families without publicly traded assets in their portfolios should have them. The wise advisor can put traditional equities and marketable securities into these large portfolios by understanding the appeal to his clients of direct investments and using that appeal to make traditional assets more palatable.

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