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Grow It, Protect It, Spend It, And Share It Wealth

THE SUMMARY IN BRIEF

Everyone dreams of striking it rich — by selling a business, scoring a great investment, receiving an inheritance or winning the lottery. Stuart E. Lucas was one of the fortunate ones who was born into a wealthy family. His great-grandfather, E.A. Stuart, began with \$25,000 and founded the Carnation Company. Eighty-six years later, the company was sold for \$3 billion to Nestlé.

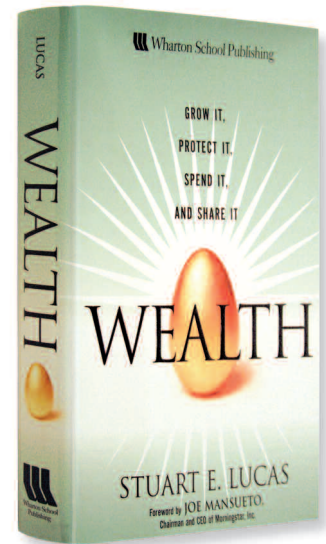
Lucas has been able to draw a unique perspective on wealth management from experiencing first-hand the thoughtful family legacy created by E.A. Stuart. The legacy included how to run a business and manage the wealth that a business creates.

In *Wealth*, Lucas shares this perspective and utilizes his 25 years as a professional wealth manager to build a flexible framework that can be customized to the unique circumstances of anyone concerned about wealth creation, wealth management, families with wealth, retirement planning and multi-generational estate management.

Lucas shows how to use this framework to protect and grow your personal and family wealth whether you are worth a few hundred thousand dollars or a few hundred million. Wealth management is not just about money, Lucas tells us, it's also about people, relationships, values, doing well by doing good and, of course, family. Wealth is a gift to be safeguarded, nurtured and shared productively with others.

IN THIS SUMMARY, YOU WILL LEARN:

- How to manage wealth received through inheritance.
- The eight principles of Strategic Wealth Management.
- How to define your values and objectives.
- How to select the right financial administrator.
- Why taxes are your ally.
- How to strike the right balance of risk taking, wealth preservation and leadership.
- How to prepare your children to be stewards of your wealth.



by Stuart E. Lucas

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THE COMPLETE SUMMARY: WEALTH

By Stuart E. Lucas

The authors: **Stuart Lucas** is a fourth-generation heir to the Carnation fortune and also a wealth management advisor. Lucas has filled the posts of Senior Managing Director of private client services at Bank One, General Manager of European Operations at the Wellington Management Company, as well as the Assistant Portfolio Manager of a Forbes Honor Roll mutual fund.

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How the Wealth Industry Works

You need knowledge to protect your interests. If you are not a proactive, thoughtful and informed client, the wealth-management industry actually works against you in three ways:

- When clients' and advisors' goals conflict, advisors may put their own interests ahead of their clients.
- Advisors are unlikely to understand or appreciate the personal and family dynamics that drive your wealth-management goals.
- Very few wealth-management professionals fully understand how the advice of one expert can potentially affect that offered by another.

Furthermore, it is not easy to measure the value added that a wealth-management firm or advisor generates for a client. This could leave you in the position of having to trust your advisors without an accurate yardstick to measure their effectiveness.

Classic Approach to Wealth Management

When selecting wealth-management advisors, prospective clients try to absorb the sales pitches with limited relevant experience. They then typically pick the most attractive-sounding presentation without a thorough understanding of what they want to achieve or the likelihood of doing so.

Since most private wealth advisors don't generate revenue until they have sold something and because many clients want the security of knowing their assets have been invested, solutions are quickly implemented. This

leaves little incentive for advisors to explain the pros and cons of all the financial options available, especially low-cost, high-value ones.

Within a month or two, the client's strategy is set, the assets 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 portfolio's performance, to offer suggestions for improvement and to make any agreed-upon changes.

Strategic Wealth Management

Strategic Wealth Management offers a new way to structure your wealth management. It is a holistic approach that explores all your strategic options while showing you how to employ your advisors to greatest effect. It focuses on your interests, putting you at the center of the framework, and it explores your values, your skills and resources and how you relate to your family.

The external context in wealth management includes the tax code, estate-planning laws and philanthropic interests. When these are coupled with your family's dynamics, you can set appropriate financial objectives and organize the right advisors to execute your wealth-management strategy.

It's Not Only About Money

Wealth aside, no two families are alike. They are complex, dynamic organisms that are forever changing. They consist of each member's beliefs, values, attitudes, norms and behaviors. Money can help a family pursue extraordinary opportunities. However, it can also foster resentment, create dependency and even lead to corruption. This is why you must take charge of your



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service@summary.com

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Rebecca Clement: Publisher, **George D. Lambert III:** Contributing Editor, **Joanne Merenda:** Art and Design, **Sarah Dayton:** Editor in Chief

wealth management by assuming the role as your family's "Wealth Strategist." ●

Eight Principles Of Strategic Wealth Management

A useful set of principles for effective long-term wealth management, which can be applied equally well to managing a nest egg of \$1 million or \$1 billion, regardless of time and family complexity, and whether your ambitions are aggressive or conservative, can be outlined as follows:

1. Take Charge and Do It Early:

You must educate yourself about your family finances and decide how to structure family and financial goals so they can become integrated and reinforce one another. If this is not done early, forces such as taxes, fees and inflation can erode your family's wealth. After you and other family members define your values, you'll have a basic template in place to develop a long-term strategy.

2. Align Family and Business Interests Around Wealth-Building Goals and Strategies:

Creating strong alignment of family members around common goals is critical to ensuring successful implementation of wealth-management strategies and goals — especially when they are multigenerational. As the Wealth Strategist, your job is to establish a legitimate rationale for people to want to work together.

You also must be adept at focusing wealth-management discussions not only on a family's history and values but also on its vision for the future. It's equally important to ensure that that advisor interests are aligned with yours.

3. Create a Culture of Accountability:

Wealth management is a business activity, and to successfully implement your strategies, you need to put accountability systems and performance metrics in place. You need a benchmark to judge the performance of the Wealth Strategist and the team of advisors. This will reinforce business goals, set expectations and drive the implementation of wealth-creation strategies.

4. Capitalize on Your Family's Combined Resources:

A family's resources become distributed among its members over time, and as assets become distributed there's a tendency to manage them separately. The

challenge is to figure out how and how much to reassemble these distributed resources so they function more effectively. Disciplined family leadership is key. But this does not only include financial resources. You must also look within to examine the combined strength of family members' personalities, experience, skills, affiliations and networks.

5. Delegate, Empower and Respect Independence:

Supporting family members to identify and pursue challenges that they can call their own, away from the family's immediate influence, encourages self-reliance and risk-taking. Furthermore, it encourages the personal growth of young adults who can learn to embrace responsibility and develop a sense of self-confidence.

6. Diversify, But Focus:

Diversification and focus combine the best of both worlds. Diversification protects your wealth by investing over a broad range of areas, and focus provides the intensity that most people need to succeed in life. Without the focus to develop investment skills that are superior to most professionals, you won't add value to your investment portfolio.

7. Err on the Side of Simplicity When Possible:

The more complex the wealth-management strategy, the more variables you have to worry about managing, and the more difficult it is to reverse course. In addition, these schemes — often highly remunerative for advisors at the time of sale — can subject clients to long-term risks. Therefore, before choosing complex solutions to wealth-management issues, evaluate the simple ones.

8. Develop Future Family Leaders With Strong Wealth-Management Skills:

To build and maintain wealth over multiple generations, you must develop future family leaders. However, no person in the next generation should come into the family business without spending at least a decade succeeding outside the family business, preferably in a related field.

Nepotism Can Be A Good Thing

Part of leveraging the scale of wealth is learning to take advantage of talents or business skills that your family members may possess. Putting family talents, skills and resources to good use is every bit as important to sound

Summary: WEALTH

wealth management as shrewd investing, strategic thinking and the clear enunciation of values.

Unfortunately, Americans have an ambivalent attitude about nepotism. Yet with the right combination of leadership, resources and structures, families can strengthen themselves through a focus on “nepotistic advantage.” This can help to reinforce positive family values and equate privilege with responsibility, ownership, commitment and accountability among family members.

Everything Begins With Values

For most of us, discussing money and wealth is difficult to do, especially in a family context. Yet having these discussions is critical for purposes of wealth-management planning and choosing the appropriate investment approaches, vehicles and timeframes to meet your needs.

What do you want to accomplish with your life and your wealth? You might want to:

- **Maximize financial security in retirement.**

You must take charge of managing your wealth if you want to live well throughout your lifetime and pass wealth on to future generations.

- **Channel your assets into additional wealth-building.** Two important things about allocating your capital are: Don’t allocate all your capital to one venture; always diversify your investments to mitigate the risk of large-scale market or business losses. Second, diversify the rest of your assets across a range of investments that have little in common with your career or your speculative business venture.

- **Create a special place to bring family together.** A vacation home can become an emotional homestead, a place to go on special occasions to nurture family bonds, enjoy a sense of community with those you love and create a retreat from pressures of everyday life.

- **Become a collector.** Collecting art or other objects can serve many purposes: fun, to build wealth, tax incentives, perhaps a family legacy in its community.

- **Donate money and/or time to worthy causes.** By “giving back” we strengthen the communities to which we are bound and make them more effective for the generations that follow us.

- **Give money and companionship to people you care about.** Financial gifts of cash, property, valuable objects or family heirlooms mean more when they celebrate the special relationships between benefactors and beneficiaries that come through shared experience. Bequeathing money across multiple generations goes far

beyond normal wealth gifting. To do it well means doing it as part of a contract of values that you and your family establish in this generation and which future generations of your family will respect when it is their turn to be stewards of your wealth and values.

Communicating About Wealth

The family culture you establish will have an impact on your children and grandchildren even if your financial assets do not. Thus, it is important to nurture a spirit of kinship among family members by identifying and reinforcing common family interests and wealth-management objectives. This should include all family members who are likely to benefit from it, even the youngest ones.

At the same time, review how wealth is to be used and what responsibilities each member will have. Such open communication is necessary to show the next generation that the privileges of wealth come with responsibilities that include maintaining family values. ●

Defining Your Financial Objectives

After you articulate the values you want to use as the basis for managing your wealth, you need to translate them into financial objectives. You are more likely to achieve your goals — and more important, gain true satisfaction — if your financial goals and values are aligned. First, though, you must select a “distribution-driven” or a “growth-driven” wealth-management style.

Distribution-Driven Vs. Growth-Driven

Distribution-Driven: A distribution-driven wealth-management strategy is built around financial goals that may include:

- A time horizon of 20 years or less.
- A high level of spending without concern of passing wealth on to the next generation.
- A lower rate of return since your assets only have to last your lifetime.
- Simple investment, tax and estate-planning strategies.
- Current gifts to satisfy your philanthropic desires.

Growth-Driven: A growth-driven wealth-management strategy could be suitable if:

- Your time horizon is multigenerational and spans decades.
- You need above-average rates of return.

- Income and capital gains taxes are a concern.
- Spending should be controlled.
- You want to implement complex tax, estate and philanthropic strategies.

Now that you know the wealth-management strategy that will fit your goals, choose from among the following five approaches to wealth-management planning:

- Maintain your purchasing power.
- Maintain a stable income.
- Conserve real wealth and your purchasing power.
- Retain real per-capita wealth across generations.
- Keep growing your wealth.

Regardless of which approach you use, you must be aware of two factors that can affect your outcome: leakages and growth.

Leakages can consist of taxes, fees and expenses associated with wealth management. Inflation is another leakage which you have no control over. Growth includes the ability to generate above-average returns. However, if you only focus on one of the factors, it doesn't work. For instance, if you think about how to get higher returns but don't consider the impact of tax efficiency or expenses, you'll end up with less in your pocket than you had expected.

Making It Work for Your Family

Each family member will have different views of money, and is at a different stage of life with plans that don't align with other family members. By developing a unified family strategy around asset growth and leakage prevention, you, as the Wealth Strategist, can reinforce common bonds and values across generations, which, in turn, will contribute to the long-term growth and preservation of your family's wealth. ●

The Three Worlds

To be an educated consumer, you must understand the three worlds of investment advisors. Each is inhabited by financial professionals ready to assist you with asset management. Nevertheless, no matter which you choose, always remember the first rule: buyer beware.

The Enchanted Forest

Wealth advisors in The Enchanted Forest use slick advertising, enthusiastic market predictions and expert commentary on the ever-changing nature of investing. They'll offer neophyte investors easy keys to prosperity.

This can make newly wealthy people, who are open to suggestions and vulnerable to persuasion, easy prey for advisors who overwhelm them with financial jargon and promises of quick market success.

Many of the advisors in The Enchanted Forest are hard-working professionals with winning personalities. They are usually competent and ethical, but sometimes not. In addition, their energy and creativity — rather than a track record of success — keeps clients coming back to these advisors for advice.

The Secret Society

In this world, inhabitants have learned how to consistently add value through good investment performance. They are driven investors and wealth advisors who aggressively seek new opportunities, yet they are modest and self-assured. They constantly look for what is wrong with their and other people's investment prospective and for ways to take advantage of those misperceptions.

This is not an easy world to enter since advisors who are in it shun publicity. Their strategies are highly confidential, customized and usually command high fees. Take caution though; there are a lot of imposters. When the advisors' luck runs out, the extra risk causes the investment to fall more violently.

The Capital Kibbutz

This is a world in which everyone who participates shares in the rewards and risks of the investment together. Here, you don't need to worry about which securities are cheap or expensive, and you don't buy or sell much. Generally you just let the economy work for you.

The Capital Kibbutz is the world of indexed mutual funds, exchange traded funds and term life insurance. The costs of market participation are quite low, allowing you to sleep well at night and pursue interests other than investing.

You won't earn the returns one experiences in The Secret Society, but so long as the economy performs relatively well, the average investor earns a better return than in The Enchanted Forest. ●

Picking Your Investment Strategy

Picking an investment strategy then sticking with it through market ups and downs is the single most important financial decision you will make. The following are three options, each with its own merits.

Index Investing

Indexing is the act of investing in a total financial market (i.e., the U.S. stock market, international stocks or the U.S. bond market) rather than trying to select specific securities. Studies have concluded that if you index, you are likely to end up with more money in your pocket than most people who choose more aggressive and time-consuming strategies.

So why don't wealth advisors push the indexing approach? There are four reasons:

- It is less profitable than actively managed funds.
- It sets a tough performance standard for active managers to beat.
- The low fees give firms less money to spend on marketing campaigns.
- It gives an advisor nothing interesting to talk about.

Barbell Investing

Picture a barbell with the weight on one side representing the management of your financial assets, probably using the Indexing Investing strategy. The counterweight is the energy and capital you have invested in your career or business. Connecting the two weights is sound, cash-flow management.

This type of investing is best if you are still working and not an investment expert. And as you build your career or business, your financial assets keep growing without a drag from spending. As a result, you can take modestly greater risks, earn more from those investments and enjoy more discretionary income in the future.

However, if you were to take a greater entrepreneurial risk and the business fails, you can rest assured that your financial assets will be there when you really need them.

The Active Alpha Investing Strategy

Active Alpha Investing involves integrating a diversified portfolio of traditional securities, for instance stocks and bonds, with exciting, high-return potential alternative investments, such as private equity, commodities and hedge funds.

People who employ this strategy are trying to get into The Secret Society. However, the majority of Active Alpha investors who succeed in their endeavors will beat the returns of Index Investing investors by only a small margin. Yet they will put enormous amounts of work into it.

Nevertheless, if executed well, an Active Alpha

Investment strategy has the long-term potential to generate a 10 percent to 15 percent annualized return in a variety of market and economic circumstances. ●

Making Your Most Important Hire

A Financial Administrator (FA) will partner with you to meet or exceed your financial goals using the investment strategy that you have chosen. The FA's role is clearly separate from that of the people who manage your investment portfolio. You want someone who is conscientious, of strong character, of high integrity, accountable to you and able to strike a balance between your interests and their employer's interests.

Regardless of which investing strategy you choose, you need an FA with in-depth experience and expertise in the following: managing financial performance, managing financial records, coordinating and recommending specialists, asset allocation and selecting investment managers.

Build a list of six or eight firms that you think can meet your needs. Include big brokerage firms, mutual-fund companies, banks and independent fee-only financial planners. Then prepare a written Request-For-Proposal (RFP). The following is a partial list of what you should include in your RFP:

- The firm's annual report.
- A brochure describing services and products offered.
- The firm's private client group organizational chart.
- An explanation of asset-allocation decisions.
- An explanation of how the firm chooses managers.
- A sample of a typical client-reporting package.
- The firm's fee structure.
- A minimum of five client references.

Can You Do It Yourself?

If you use the Index Investing Strategy, your family and financial circumstances are fairly simple, and you have the time and desire — yes, then you can. You could use firms like Vanguard that have a wide range of index investment products with the ability to track aggregate investment performance. And companies, such as Morningstar, have services that allow you to measure the individual and aggregate performance of all your mutual funds. Although acting as your own FA can be time-consuming, it can be rewarding and inexpensive with the right tools and dedication. ●

Taxes Can Be Your Ally

Taxes rank as either No. 1 or No. 2 on the list of expenses for the wealthiest Americans. And stopping this leakage should be a critical element in your investment strategy. Yet most investment managers don't concern themselves much with tax minimization because doing so doesn't reap them any bottom-line benefits. Therefore, you need to assume the responsibility to evaluate the after-tax performance of your investments in order to make taxes your ally in the wealth-management planning process and keep an eye on the big picture of tax minimization and efficiency.

You may have always thought that the IRS was an adversary. Consider these three points and you might change your mind:

- The government allows each taxpayer to apply the code's rules to his or her own advantage. This means that our actions and decisions impact our tax liabilities.
- The tax authorities don't make any money unless you do.
- The government provides services, such as defense, social security and roads in exchange for taxing you.

The tax code offers strong incentives for investors to think and act long-term. The top short-term capital gains tax rate is 35 percent. So if you sell an investment within one year or less from the day you bought it, you are taxed at this rate. However, today's top long-term capital gains tax rate is 15 percent — a full 57 percent lower, and you don't pay the tax until you sell. Deferred capital-gains taxes are like interest-free loans.

Improve Investment Results Through Tax Management

You can add to your portfolio's value by managing your taxes well. First, hire only a few broadly diversified, tax-efficient managers. Tax-efficient managers will hold winning investments longer, thereby allowing you to accumulate accrued taxes and share the investment risk with the government.

Next, start saving for retirement as soon as possible, even if it is 40 or 50 years in the future. This will help you make the most of the world of compounding. And if your tax rate is high, take advantage of IRAs, Roth IRAs or 401(k) plans.

Finally, be aware that high management fees and low returns are a bad combination. When this happens, you suffer doubly because your taxes are calculated before subtracting fees.

Avoid tax-deferred vehicles. Insurance companies sell

tax-deferred vehicles, such as variable annuities and life insurance savings plans as a way to postpone taxes until you withdraw money. However, even a modest hike in income tax rates can eliminate the benefits such products offer. On top of that, many of these structures have high administrative and investment fees that hack away at your investment's return. ●

Promoting Entrepreneurial Stewardship

Entrepreneurial stewardship involves striking the right balance of the following three areas to ensure your family can deal successfully with threats to its prosperity and harmony:

- Taking investment risks when good opportunities avail themselves.
- Preparing the next generation for the responsibilities of wealth management.
- Assuming strong family leadership.

One of the best ways to address the challenges of entrepreneurial stewardship is to combine a culture of openness with the opportunity for individual family members to opt out of family wealth-management activities. Then you are giving them a choice between sharing the benefits of commingled management of their assets on the terms offered or the option of acting independently. ●

Making Philanthropy Part Of Your Strategic Wealth Program

Philanthropic pursuits and public service can become a family's primary area of focus and thus tie a family together.

There are various ways to structure your gifts, depending how much control you want over the gifts and your desire to remain anonymous. The options include:

- Direct donations to 501(c)(3) organizations.
- Gifts to support organizations that have endowments to support an institution, such as an educational or a religious organization.
- Donations to donor-advised funds available through Fidelity, Vanguard and other financial institutions.
- Charitable lead trusts.
- Charitable remainder trusts.
- Private foundations.

Money, however, is not the only asset you can give. You will become a better philanthropist by getting directly involved in working with non-profit organizations. This is a chance to use your business skills and be confident that the organizations to whom you donate use the money well, and you will find it gratifying. ●

Multigenerational Planning And Wealth Transfer

You want to avoid estate plans that involve rigid legal structures, administrative overload, inadequately defensible positions if confronted by the IRS and whopping legal bills. Keep it simple and focus on three fundamental points: ensure that core needs of each generation are met, reinforce family harmony and empower subsequent generations.

Rather than thinking about “how much” to leave your children, you should be thinking about “how” you will leave it to them.

Primary homes and secondary/vacation homes can be integral to a family’s traditions, but costly to maintain. As a family grows, there will be varying degrees of interest in these family assets and differing desires or abilities to manage them. Also there might be the urge by your children to sell a highly appreciated piece of property. Various legal techniques exist that can transfer real estate to your children.

However, before you do that, prepare a written operating agreement that spells out how they will handle the expenses, operations, scheduling and potential sale.

Intergenerational family lending is also one of the best estate-planning techniques around. For instance, an intergenerational, leveraged buyout freezes the value of a company for one generation and allocates any additional value to the next one. Another example would be a new business venture started with funds loaned to a child.

Prepare Estate Plans to Create Income Streams

You can create income streams for your children and grandchildren to tap immediately after your death or years thereafter. Or you can set up a plan that will kick in when the beneficiary reaches a certain age or milestone. Maybe you need to create an income stream to protect the financial security of someone who cannot fend for him or herself.

Retirement plans, such as IRAs and 401(k) plans, allow

you to name direct beneficiaries. Irrevocable trusts, however, offer a more effective way to pass assets to future generations. Since a trustee manages the trust’s affairs according to the law and terms you established, the assets within the trust are protected from creditor claims, including bankruptcy lawsuits, divorce and liens.

Family companies and family partnerships are additional structures people use to transfer wealth and create income streams for beneficiaries. In many cases, they are designed to limit the liability of some or all participants. And unlike irrevocable trusts, the governing documents can be modified to suit changing circumstances.

Complex estate-transfer plans can be hard or impossible to change after they are put in place. Therefore, it will be worth the money to hire someone who is very knowledgeable, not only about estate law, but who also understands family dynamics and can advise you on how to administer an estate for many decades — regardless of the structures you set up.

Must-Dos

There are certain things you must do. Otherwise you will undermine everything you’ve accomplished in your wealth building.

- Write a will that clearly states your intentions for disposing assets not included in a trust.
- Set up a revocable trust to keep most of your assets out of probate.
- Set up a marital trust to protect your spouse’s security while allowing you to have control over the eventual distribution of the assets.
- Consider giving assets to your spouse if you control most of your family’s combined assets.
- Consider irrevocable trusts to provide for your children after you die.

Creating and Maintaining a Legacy

As the final leg of wealth management, estate planning should focus on three fundamental issues. First, is the assurance that you can live the rest of your life feeling financially secure and knowing that your heirs will have that same financial security. Second, is setting up an estate plan to prevent or minimize friction that can often undermine well-intended financial plans. Finally, the third component is realizing that you can transfer your wealth in such a way as to motivate and empower your heirs to aspire and succeed. ●