

# Uncommon success

Wealth strategy for entrepreneurs and business owners



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#### **Business owners report**

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## Introduction

# The exit boom



Baby Boomers, typically defined as having been born between 1946 and 1964, led an education boom, an employment boom, and a real estate boom. They are now aged 55-73 and in the midst of a retirement boom. We are also in a business exit boom, as Boomer entrepreneurs seek liquidity and a transition out of their businesses.

Concrete data on private business owners can be challenging to find, but whether you look at public or private data it all points in the same direction: A substantial majority of private businesses are owned by Baby Boomers. In aggregate, those businesses represent trillions of dollars of assets that will change hands – in one way or another – over the next three decades.

By most accounts, Boomers are increasingly ready to exit their businesses (Fig. 1). 57% of business owners in this group intend to retire in the next five years, and 76% intend to retire within the decade.<sup>1</sup> Unfortunately, many business owners will end up exiting later than expected because they underestimate the planning that is required for a successful sale. Over half of business owners have never had their business appraised and nearly half haven't put a formal exit strategy in place.<sup>2</sup>

We also find that there are other challenges inherent in selling a business that can slow the process. Common hurdles include uncertainty as to whether key employees or family members have an interest in running the business, insufficient investment planning to confidently shift away from living off the income from the business, and lack of clarity regarding feasible exit strategies.

This report attempts to provide clarity to many of the uncertainties business owners face.<sup>3</sup> We've arranged it in three sections:

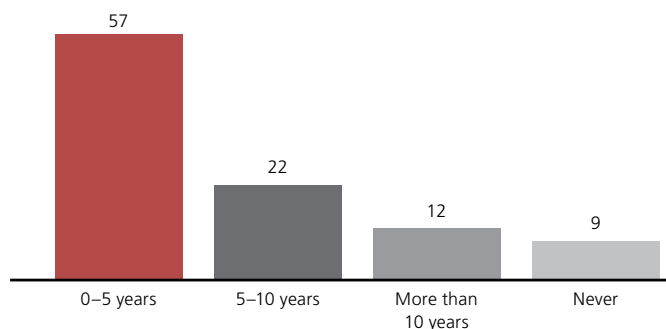
1. Pre-sale topics
2. Core concepts for the sale
3. Post-sale considerations

We haven't attempted to be fully comprehensive regarding every detail a business owner must consider. Instead, we present a structured framework to guide decision-making and have focused on the major investment-related decision points faced by business owners before, during, and after the sale.

Figure 1

### Many business owners plan to exit within the next decade

Survey of intended exits by business owners, in %



Source: © 2017 Business Enterprise Institute, Inc. Survey of business owners between 40 and 69 years of age with annual revenues between USD 500k – 500mn.

<sup>1</sup> © 2017 Business Enterprise Institute, Inc. Survey of business owners between 40 and 69 years of age with annual revenues between USD 500k – 500mn.

<sup>2</sup> Preparing for what comes next: Life after the sale of your business, UBS Business Owner Insights, Q4 2018.

<sup>3</sup> UBS Investor Watch Report "Who's The Boss," February 2018.

# Chapter 1

## Pre-sale

### Know thyself

"When your values are clear to you, making decisions becomes easier." – Roy E. Disney

All business owners, planning an exit or not, should start by going through a deliberate process to understand the outcomes that are important to the owner and his or her family. We can't plan and invest appropriately without first identifying the desired outcomes. Five simple questions can provide an entry point to this conversation:

1. What do you want to accomplish in your life?
2. Who are the people that matter most to you?
3. What do you want your legacy to be?
4. What are your main concerns?

Ultimately, those four questions lead to a fifth:

5. How do you plan to achieve your life's vision?

We don't expect everyone to be able to answer all (or any) of these questions at first glance. These questions deserve and require careful, deliberate thought. We find that business owners, in particular, tend to focus so closely on running and growing their business that some have never put much time into these issues.

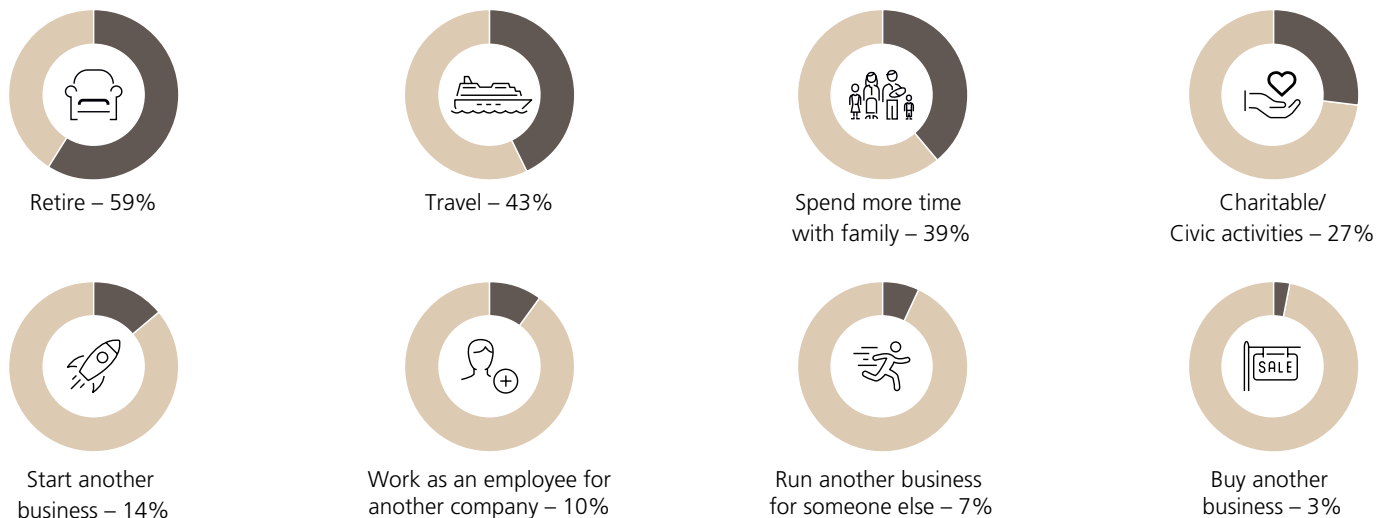
The answers, of course, will change over time (Fig. 2). We also find that they shift in regard to priority. An accomplishment goal that starts as an objective to create and grow a successful business can transition to a Legacy goal to effectively transition the business to family or employees. Concerns change over time, as do the relationships we have with those close to us.

Regardless, the information that comes out of this process is invaluable for effectively managing assets pre-sale, structuring the sale in an optimal manner, and then developing a strategy for the proceeds after the liquidity event.

Figure 2

### Most business owners don't plan to start a new venture

What are your plans, post-exit?



Respondents allowed to answer with more than one choice.

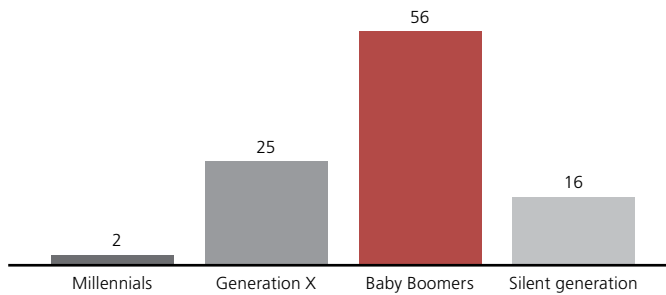
Source: © 2017 Business Enterprise Institute, Inc. Survey of business owners between 40 and 69 years of age with annual revenues between USD 500k – 500mn.

Timeframes may vary. Strategies are subject to individual client goals, objectives and suitability. This approach is not a promise or guarantee that wealth, or any financial results, can or will be achieved.

Figure 3

For USD 1mn+ households with a business owner, 56% contain a head of household from the Baby Boomer generation.

By head of household's age, in %

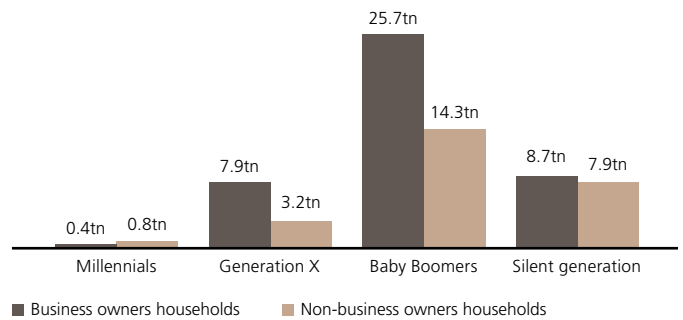


Source: 2016 Survey of Consumer Finances, Federal Reserve, UBS

Figure 4

The combined net worth of business owner households from the Baby Boomer generation is almost double that of non-business owner households.

By head of USD 1mn+ household's age, in USD



Source: 2016 Survey of Consumer Finances, Federal Reserve, UBS

### Business owners are unique

*"Two roads diverged in a wood, and I—  
I took the one less traveled by, and that has made  
all the difference."* – Robert Frost

Business owners are generally wealthier, older, and have a more-concentrated balance sheet than the average investor.

Most countries don't track balance sheet information on an ongoing basis, but in the US the Federal Reserve has been tracking this information for families on a triennial basis since 1983.<sup>4</sup> Although there might be some regional distinctions, we believe this data provides a reasonable picture of business owners globally.

There are 127mn households in the US, but only 15mn (12%) have a net worth of 1mn or more. Of those +1mn net worth households, 42% contain a business owner. Nearly 85% of households with a net worth between USD 20mn and USD 100mn own a business. Even more striking, there are only 37,000 households with a net worth above USD 100mn in the US. 95% of those households are business owners. Successful business ownership continues to be one of the main drivers of wealth accumulation for families.

Despite the popular focus on Millennial tech entrepreneurship on the West Coast, only a small percentage of entrepreneurs are in their 20s and 30s. For business owner households with a net worth greater than USD 1mn, more than half contain a head of

household from the Baby Boomer generation (Fig. 3). Furthermore, this group of households has a combined net worth of USD 25.7tr, almost twice the wealth of non-business owner households in this segment (Fig. 4).

Perhaps the most obvious and clear area of differentiation between business owners and everyone else is the large, concentrated, and generally illiquid position business owners have on their balance sheets. On average, liquid financial assets comprise just 35% of business owners' balance sheets. Non-business owners average nearly double – 65% – of their assets in liquid securities (Fig. 5 on page 6).

### The asset allocation conundrum

*"If you don't know where you are going, you might end up somewhere else."* – Yogi Berra

Business owners tend to follow one of two general frameworks for managing their assets while they still own the business. One extreme recognizes the significant risk that a concentrated position in a private business lends to the family and recommends that they hold most of their investable assets in something

Despite the popular focus on Millennial tech entrepreneurship on the West Coast, only a small percentage of entrepreneurs are in their 20s and 30s.

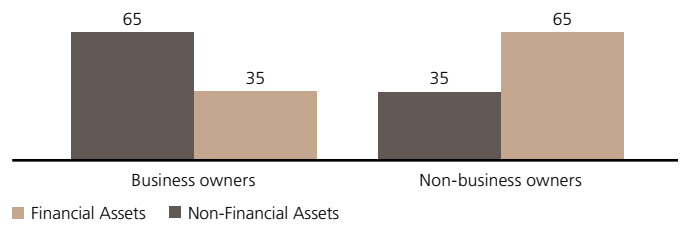
<sup>4</sup>Data in this section comes from the Federal Reserve's 2016 Survey of Consumer Finances.



Figure 5

On average, non-financial assets account for nearly two-thirds of business owner's total assets.

Households with USD 1mn+ net worth, in %

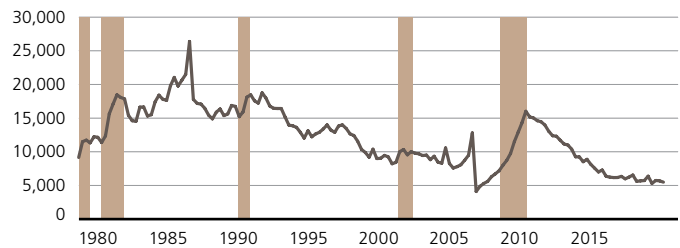


Source: Federal Reserve, 2016 Survey of Consumer Finances, UBS

Figure 6

Business bankruptcy filings are only partly related to the business cycle.

Shaded area represent periods of recession



Source: American Bankruptcy Institute, NBER, UBS

with very low day-to-day volatility, like municipal bonds or cash. The other extreme takes the opposite approach entirely, and invests as if the business didn't exist. Neither is optimal. A significant drawback to the first approach is that it assumes that a decline in the value of the business will be correlated to other, publicly traded, risk assets. It is true that the market value of nearly all businesses ebbs and flows with the economic cycle, and that bankruptcies increase during recessions (Fig. 6). However, failures of established, well-functioning companies tend to be either sector-based (e.g., technology firms in 2000 and energy firms in 2015) or idiosyncratic to the company itself.

Over reasonable periods, individual company performance rarely moves inline with the overall performance of the broad, public equity market.

Accordingly, a business owner with some liquid assets could potentially have better outcomes by owning a diversified portfolio even if his or her company failed, assuming those assets were not needed during the failure period and those public equity assets were not heavily concentrated in the same sector as the private business.

On the other hand, completely ignoring the private business presents its own problems for asset allocation. Family and company

balance sheets tend to be intertwined, so a negative period for the business can have a significant and long-lasting impact on the family. We don't want a business downturn to lead to a liquidity issue for the family. Additionally, while a newly unemployed worker can usually find similar work within six months, shuttering a business and deciding on next steps might take significantly longer. For these reasons, families shouldn't entirely ignore their business ownership when setting investment strategy.

That earlier point about not intentionally concentrating in the same sector is related and important. We often see business owners use their liquid assets to invest in the same sector as their personal business. Energy company owners invest in other energy-related firms. Technology entrepreneurs invest in other tech companies. This phenomenon is referred to as familiarity bias.

Behavioral finance research has shown that we're more likely to invest in things that seem familiar to us: Stocks and bonds from our home country, stocks of companies frequently discussed in the media, and companies that are in the same sector we work in. Business owners have tremendous insight into companies that are similar to their own, but additional concentration isn't a risk worth taking.



### Athletes and business owners

*"We can learn to see each other and see ourselves in each other and recognize... that [we] are more alike than we are unlike." – Maya Angelou*

Business owners might look to another group of investors that have to manage large, illiquid, concentrated positions: Athletes. Business owners use their human capital to build large, successful enterprises. Athletes use their human capital to perform at the highest level in their sport.

Human capital is broadly defined as the attributes that enable someone to produce economic value through his or her labor, including knowledge, skills, training, creativity, and judgment, among other traits. Human capital can be applied toward working for a wage, being an entrepreneur, or competing as an athlete.

Professional athletes are, in fact, not that different than successful business owners. Successful athletes beat the odds. Roughly three out of every 10,000 high school athletes eventually make it to the major professional leagues.<sup>5</sup> They also have a very concentrated position—their highly-trained athletic human capital—on their balance sheet. For many athletes, their athletic human capital represents the most valuable asset they will ever own. Liquidity events also occur over a short period of time, as most athletic careers are limited in duration.

Business owners also have to beat the odds. It is thought that most – 96% or so – of new businesses

fail in short order. Of the 4% that survive, a select few create meaningful wealth for their founders. Only three out of every 10,000 households in the US have a net worth above USD 100mn, and virtually all those households created their wealth through a private business.<sup>6</sup>

From a wealth management standpoint, professional athletes have to manage a very concentrated human capital position that is liquidated in a short period of time, all while ensuring that the proceeds from their human capital are (hopefully) sufficient to pay for their post-career spending. Should they only invest in cash and bonds? The short answer is no. It's true that their career could be cut short by injury or their sport could become less popular, but bonds can't hedge those idiosyncratic risks. Aside from having sufficient liquidity available to bridge the gap between their playing careers and retraining for whatever is next, holding a well-diversified portfolio leads to better long-term outcomes.

Business owners face a similar scenario, although it typically occurs much later in life. After spending years or decades building a company (in effect, converting their human capital into a valuable business), they need to exit the business with sufficient liquid assets to pay for their future spending. The exit tends to occur in fast succession or all at once. If the business fails or the exit is less productive than desired, business owners need sufficient liquidity to sustain their spending until they can retrain or find employment else-

<sup>5</sup> 2018 NCAA Research

<sup>6</sup> 2016 Survey of Consumer Finances Public Data Files

where. Figures 7 and 8 illustrate the hypothetical path of human capital/business capital for athletes and business owners over their lifecycle.

### Asset allocation for business owners

*"If you think being an entrepreneur is risky, try working for someone else for 40 years..."*  
 – Warren Buffett

Business owners are best served by allocating their pre-exit financial assets based on the ultimate purpose of those assets. Our Liquidity. Longevity. Legacy. approach to structuring wealth across time can provide the guidance necessary for those decisions.

First, we expect most business owners to hold larger Liquidity strategies, comprising mainly an emergency fund, than their salaried brethren. Average duration of unemployment following job

loss averages six months, but during the financial crisis, duration of unemployment peaked at 40 weeks. Accordingly, we generally recommend emergency funds that are sufficient to provide for a family for about one year – sufficient time to find new employment with a large margin of safety.

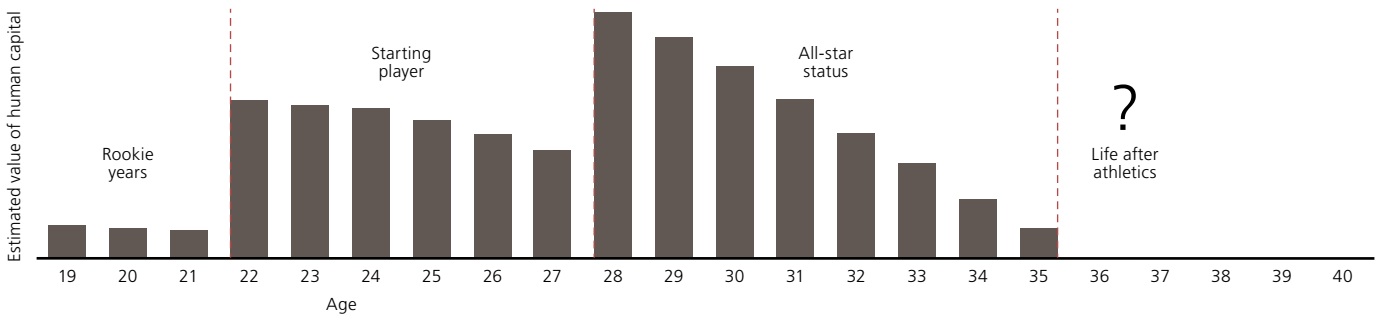
Business owners, on the other hand, might need significantly more time to restructure their business, shut down their business, or retrain in a new field. It's reasonable to hold 3-5 years of spending in a Liquidity strategy along with an asset-based borrowing facility as a stop-gap for those periods. If the Liquidity portfolio or line of credit isn't ever utilized, foregone returns should be seen as a small price to pay for preventing an unnecessary hardship during an already stressful period.

Next, any additional investment assets that are not needed for the Liquidity strategy can begin to populate the family's Longevity

Figure 7

### Athletes can have sharp spikes and declines in human capital

Pro athletes can make a lot of money in a short period of time

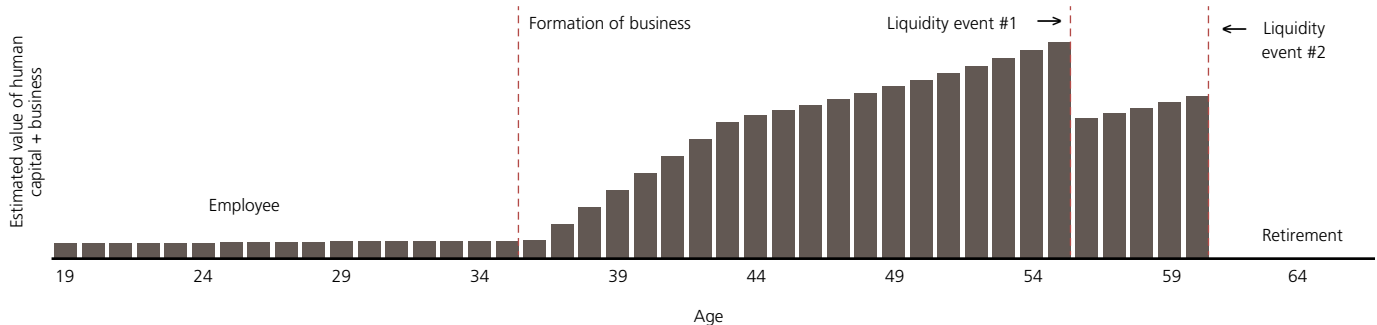


Source: UBS

Figure 8

### Business owners can also have fast exits

Illustrative life-cycle of human capital and business value



Source: UBS

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## Business owners are best served by allocating their pre-exit financial assets based on the ultimate purpose of those assets.

strategy. One important question in doing so is whether or not individual private businesses are highly correlated to the public equity market. We obviously don't have a database of ongoing valuations for private businesses in the US, but a reasonable proxy is the microcap public equity space. The Russell Microcap index consists of roughly 1500 companies with a median market cap of USD 220mn.

Overall, the microcap index is highly correlated to US equities. However, individual companies within the index are not. Of the 1500 companies in the index, 1200 (80%) have a correlation to the S&P 500 of 0.5 or less. The median correlation is 0.3. That's low. For perspective, we expect corporate investment grade fixed income to have a correlation of about 0.3 to US equity. A correlation of 0.5 is about the same as emerging markets fixed income and US equity.

Just to be clear, low correlation doesn't mean "not risky." Microcap stocks exhibit very high volatility, which is an indication that although they don't have a lot of market risk they have a massive amount of idiosyncratic risk, on average. Private businesses and private equity should be viewed the same way.

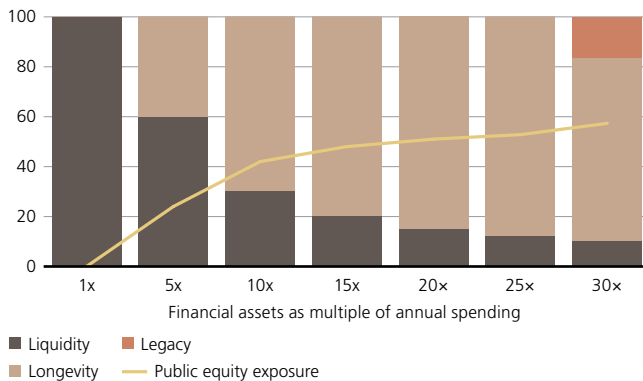
Absent a clear correlation between the value of the company and the stock market, our recommendation is that most Longevity strategies should be invested in moderate or moderately aggressive portfolios pre-retirement. Since most of the risk inherent in a private company is idiosyncratic, public equity market exposure actually diversifies the overall balance sheet.

This process provides a bottom-up method for allocating the overall portfolio. Instead of the typical approaches – to either be very conservative or ignore the business interest – the final allocation is dynamic, based on the spending needs of the family and the total investable assets they have available (Fig. 9). The concentrated business position matters, but so does the ratio of investable assets to annual spending. In fact, as investable assets increase, the Longevity portfolio increases as a percentage of assets, thereby increasing equity exposure overall. The ultimate investment strategy is one that isn't entirely risk averse, but it also doesn't ignore the presence of the business on the balance sheet.

Figure 9

### Capacity for equity risk increases with financial assets

Illustrative equity exposure based on ratio of financial assets to annual spending, in %



Source: UBS

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## Chapter 2

# Core concepts for the sale

Almost all families have a minimum price at which it is practical to sell their business.

### The sale price: Is it enough?

*"When it's time for me to walk away... my mind, my body, my conscience tell me that enough is enough." – Jerry West*

One of the first considerations most business owners focus on when they start considering an exit is whether or not the proceeds will be suitable to fund their future spending goals. The analysis required for calculating this issue can be a bit technical but extraordinarily clarifying during the process of exiting a business. In some cases, we've found clients could sell their business earlier than they expected. In others, clients have decided to postpone the sale and focus on making certain changes to increase the value of the business.



Almost all families have a minimum price at which it is practical to sell their business. That floor represents the asset pool needed to pay for their future lifetime spending (i.e., fully fund their Liquidity and Longevity strategies). From a technical standpoint, the proceeds of the transaction need to at least equal the net present value of future spending for the family. If future spending objectives exceed the post-sale asset base, the family will face a severe risk of running out of money at some point in the future.

In simple terms, every dollar each of us wants to spend in the future can be quantified as a cost in today's terms. In order to spend USD 100 in 5 years, you need to have saved USD 84 today. In order to spend USD 100 in 15 years, you need to have USD 62 saved. USD 84 and USD 62 are the *present values*<sup>7</sup> of the cash flows that occur in 5 and 15 years, respectively.

For example, we worked with a family that wanted to maintain a spending level of approximately USD 400,000 per year following the sale of their business

and also purchase a USD 1mn vacation home. They were in their mid-60s, so we used a 35-year horizon to cover their lifetimes. The present value of a USD 400,000 spend each year for 35 years plus the USD 1mn vacation home adds up to USD 13.1mn, which was the dollar amount necessary to fill their Liquidity and Longevity portfolios. In this particular situation the net proceeds of the sale were expected to be meaningfully higher than USD 13.1mn, but had they not been sufficient the family would have needed to either reduce their future spending objectives or think about ways to achieve a higher sale price for the business.

In addition to quantifying the current cost of personal spending needs, some families have specific Legacy objectives they prioritize. This might include funding trusts, specific philanthropic gifts, or multi-generational bequests. One recent family we worked with wanted to fund a special needs trust with USD 10mn in 20 years. Using the same present value analysis, the USD 10mn funding in 20 years is equivalent to USD 5.7mn of their assets today.

<sup>7</sup> Net present value (NPV) can be quantified as  $NPV = CF/(1+r)^n$ , where CF is the cash flow, r is the discount rate, and n is the period number. We have used 3% as the discount rate and a 2.1% inflation rate in these examples.

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Bringing together the two examples from this section, a family that wanted to spend USD 400,000 for 35 years, purchase a USD 1mn vacation home, and gift USD 10mn into a special needs trust 20 years from now would need at least USD 18.8mn in current assets to have a high probability of accomplishing those objectives (Fig. 10 Scenario A).

If the expected transaction value falls short of this number, there are a few viable options to consider:

1. Explore an alternative transition type that could bring a higher valuation
2. Postpone the sale and implement a plan to enhance the value of the business
3. Reduce targeted future spending to bring it in line with post-liquidity event resources

### Give now or later?

*"We make a living by what we get. We make a life by what we give." – Winston Churchill*

Business owners frequently have an opportunity to enhance the after-tax value of the proceeds from their liquidity event by transferring a portion of ownership prior to the sale.<sup>8</sup> For example, if the family in the previous example knew that it wanted to donate USD 10mn of the proceeds from the transaction to charity, they might be better off donating USD 10mn of the business interest pre-transaction (and therefore pre-tax) to fund a donor advised fund than donating USD 10mn of after-tax proceeds (Fig. 10, Scenario B). Similar tax advantages can possibly be gained through judicious use of trust and estate planning.

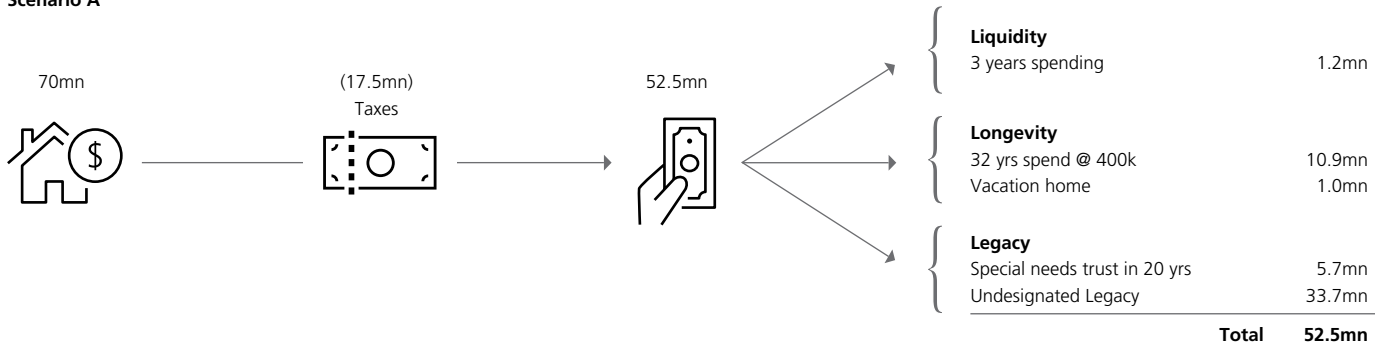
Families must balance gifting with their own spending needs. Gift too much and they might need to reduce their own expenses down the road. Gift too little and they've missed an important opportunity to have a larger impact with pre-tax dollars. The information derived from the net present value analysis discussed in the last section can be helpful for guiding these pre-transaction decisions.

Figure 10

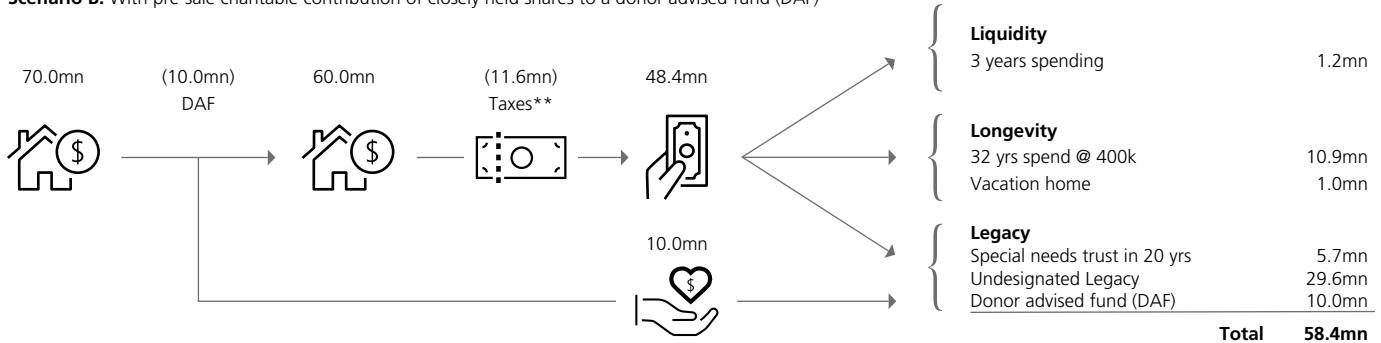
## Using the 3Ls when developing a post-exit roadmap can uncover pre-exit opportunities

Hypothetical segmentation (All values in USD)

### Scenario A



### Scenario B: With pre-sale charitable contribution of closely held shares to a donor advised fund (DAF)



\*Accounts for donors income tax savings from charitable contribution to DAF.  
Source: UBS

<sup>8</sup> For more information please see "When to give to charity: Before or after the sale of a business," UBS Advanced Planning, 2018.

## Chapter 3

# Post-sale considerations



Following the sale of a business, families need to transition from thinking like business owners to thinking like long-term asset managers. Along with that transition come a number of possible challenges. Two are investment specific: (1) selecting a prudent, sustainable asset allocation that best meets the family's needs and (2) timing the implementation in a responsible way.

### Strategic asset allocation

*"Any fool can make a fortune. It takes a man of brains to hold onto it after it is made."*

– Cornelius Vanderbilt

Many wealthy families don't need to invest their assets. They could, in a general sense, hold their assets in cash and never run out of money during their lifetimes. An all-cash strategy reduces the likelihood the fortune will be sustained over multiple generations, and unexpected high inflation presents a specific risk, but most of the time the current generation will be fine with an all-cash strategy.

On the other hand, many wealthy families could also invest the entirety of their assets in public equities and, even with a drawdown of 50%, still be okay. An all-equity strategy has more upside than an all-cash strategy but also runs the risk that a severe bear market will permanently impair the net worth of the family. Many families find once-dynastic wealth has been depleted in just a few generations due to the

combined effect of high spending, budgetary inflexibility, and failure to manage through bear markets.

History has shown that the optimal portfolio lies somewhere in between all-cash and all-equity. A dynamic balance of stability and growth is necessary. Post-sale, families can find that balance by continuing to use the Liquidity, Longevity, Legacy, framework to develop an asset allocation strategy that fits their needs and objectives. The overall sizing of each strategy drives the top-level asset allocation, taking into account the various, sometime conflicting objectives, of income, long-term growth, and multi-generational sustainability.

The exit itself can be seen as a swap out of the business position into liquid assets, which (1) fulfills the Longevity target value to provide for the living expenses of the family and (2) usually results in some level of Legacy assets the family can use for gifting or philanthropic purposes.

### Liquidity strategy

*"Wealth is not determined by investment performance, but by investor behavior."* – Nick Murray

Post-sale, a Liquidity strategy serves three main functions: (1) to match cash flow to expenses, (2) as a funding source during periods of market distress, and (3) to help avoid forced or panic selling during bear markets.

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We construct a Liquidity strategy for investors by matching cash flow to spending needs for the next three to five years. An investor's Liquidity strategy generally consists of stable income strategies, flexible cash flow strategies, and an asset-based borrowing facility. Once we have a clear understanding of the amount and timing of planned spending, we match that spending to sources of stable income and then fill the gap with flexible cash flow strategies.

### **Longevity strategy**

*"For the unlearned, old age is winter; for the learned, it is the season of the harvest."*

– *The Talmud*

The choice of the Longevity portfolio's asset allocation is important, and there are some considerations that we take into account when determining an appropriate strategy:

### **1. The volatility of an investor's combined Liquidity and Longevity portfolio directly impacts the volatility of their future spending.**

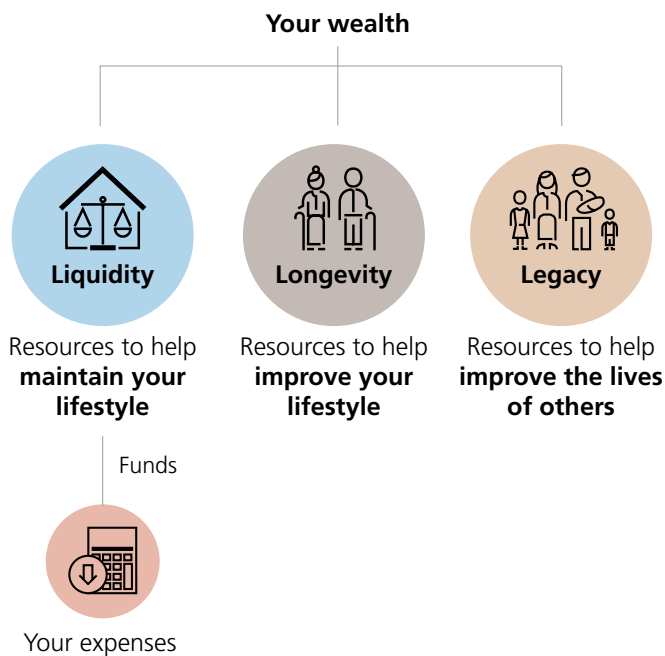
### **2. Portfolio drawdowns, in particular, present a meaningful risk.**

### **3. Risk tolerance – particularly as it relates to a pain threshold that would result in selling equities during a downturn – looms large for long-term success.**

What do we mean when we say that the volatility of an investor's portfolio is directly related to the volatility of their future spending? An example might clarify that statement. Currently, a fair estimate of the maximum spending potential of a USD 1mn portfolio (for an investor with a 30-year horizon) is 4.8%, or USD 48,000 per year. How do we get that number? Using a discount rate of 2.75% (the current average across the Treasury curve), the net present value of USD 48,000 for 30 years is USD 1mn. The net present value of a retiree's future spending has to be equal to or less than the value of the assets at retirement.

If an investor is spending at that rate and the portfolio declines by 25%, a perfectly normal equity market drawdown during a mild recession, the

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Source: UBS

now USD 750K portfolio can still safely generate 4.8%, but the dollar amount has also declined by 25%, to USD 36,000 per year.

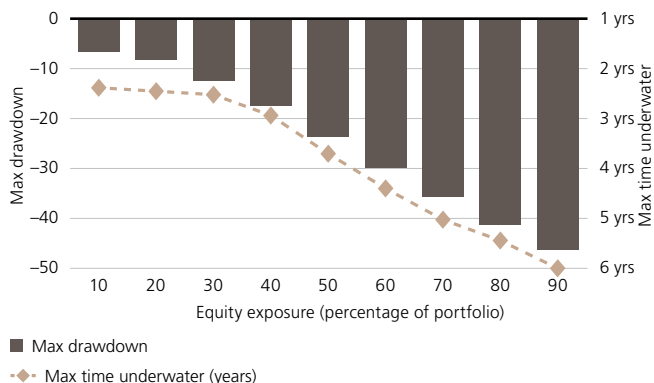
There are a couple of important takeaways from understanding the linkage between portfolio volatility and spending volatility. First, it's important to understand how comfortable an investor is with fluctuations in their spending or whether they have a buffer. Some families have lots of flexibility in their budgets or are conservative in regard to their spending relative to their overall assets. Others are unwilling to adjust their spending over time or want to spend as much as possible. Those with spending flexibility can afford to take more risk in their portfolios, but investors without flexibility need to hold correspondingly low-volatility portfolios to match their spending needs (Fig. 11).

Families that have recently sold businesses, in particular, might want to be particularly cautious in regard to the overall risk in their Liquidity and Longevity strategies. Like recent retirees, it's usually impractical for them to consider going back to work in order to replenish an investment portfolio that declined precipitously.

Figure 11

### Max drawdowns increase with equity exposure

Max drawdowns for stock/bond portfolios and time to next all-time high, 1945-2018. In %



Note: Portfolios in this example consist of intermediate duration Treasuries and US Large cap stocks.  
Source: Morningstar Direct, UBS

To put a fine point on this concept: an investor with zero willingness to have any fluctuations in their spending should hold a ladder of Treasury bonds that mature each year in the desired value of their spending. An investor with high capacity for spending flexibility could hold a 100% equity portfolio. Those are extreme examples, but they speak to the important connection between portfolio volatility and capacity for spending.

Second, drawdowns, in particular, present a risk for future spending. We believe it is prudent – even advisable in many circumstances – to hold hedging positions in Longevity portfolios that will help reduce drawdowns, even if it means giving up some upside. Examples might include momentum-based strategies that cut equity exposure during a sell-off (the UBS SAP Strategy is one example),<sup>9</sup> holding long-duration Treasuries as a bear market counterbalance, or even utilizing option strategies and structured solutions when viable.

Finally, we believe it is important for risk tolerance to set a cap on the overall volatility of the Longevity portfolio. Families have to be comfortable with their portfolios in order to avoid behavioral mistakes, and many business owners will really only experience the volatility of public markets for the

<sup>9</sup> For more information about Systematic Allocation Portfolio's (SAP) see: Systematically and dynamically managing portfolio equity risk, UBS, December 2017. Timeframes may vary. Strategies are subject to individual client goals, objectives and suitability. This approach is not a promise or guarantee that wealth, or any financial results, can or will be achieved.



first time after they sell their business. Behavioral mistakes, like selling risk assets during a bear market, turn temporary losses into permanent losses, and need to be avoided at all costs.

### **Legacy strategy**

*"The great use of life is to spend it for something that will outlast it." – William James*

Legacy asset allocations are idiosyncratic. To the extent that they are meant to sustain multi-generational wealth, Legacy strategies can be thought of as analogous to taxable endowment strategies. Even so, many investors have various structures, like trusts, educational accounts, and philanthropic accounts. Each needs to be managed in a specific way to best meet its objectives.

Perhaps the most important concept for investors to think about with regard to Legacy portfolios is the interplay between time horizon and investment risk. Although some financial economists debate the nuances of this point, there is a trade-off between short-term and long-term risk that families need to embrace when managing long-term assets.

For instance, if I am a short-term investor and I focus on the day-to-day volatility of my portfolio,

cash is a safe asset. Equities, on the other hand, are very risky, since the value of the equity portfolio can swing wildly over fairly short periods.

However, if I am a long-term investor, ignore day-to-day fluctuations, and care only about the long-term (inflation-adjusted) value of my portfolio, cash becomes a very risky asset. There's very little certainty that USD 1mn sitting in cash will retain its purchasing power over the course of a decade. Equities, by contrast, rarely lose inflation-adjusted value over ten-year periods. The path might be more volatile, but there's more certainty over the long horizon.

### **Implementation strategy**

*"What's the most you've ever lost on a coin toss?" – Anton Chigurh*

Salaried workers have at least one major advantage over business owners when it comes to investing: They get hundreds of entry points into the market over the course of a career. Sometimes they will buy high, sometimes low, but they effectively dollar cost average into the market over 30-40 years. The timing of any one purchase ends up not mattering very much overall.

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Business owners, on the other hand, don't typically have the same luxury. The large influx of assets from the sale of the business means they will, for the most part, have a fairly concentrated entry point into the market from a time standpoint. That, itself, presents a risk, since many businesses are sold near the latter parts of the economic cycle when valuations are elevated and enhance the attractiveness of a liquidity event occurring in the first place.

Investors with large amounts of capital to put to work face a tradeoff between the opportunity cost of delayed implementation and the psychological damage that could come from a sharp, immediate decline in their newly-invested portfolio. On this point we're being specific when we say that an immediate market sell-off presents a psychological cost instead of an economic cost. Poorly designed portfolios can certainly lead to much worse outcomes over time, but a well-designed investment strategy should be able to manage through those periods. All families will eventually face recessions and bear markets. We just want to avoid, if possible, the emotional toil of experiencing it immediately after the sale of the business.

Our advice, accounting for all of these considerations, is to use a dynamic dollar cost averaging strategy, along with considering return-enhancing strategies, like selling put options, to implement sale proceeds. We find that it's most effective to follow a written plan and to have the full proceeds imple-

mented within a reasonable timeframe. Our report "Investment strategy insights: How should investors deal with lump sums?"<sup>10</sup> provides a full strategic overview for doing so.

### Conclusion

We'll end where we began:

1. What do you want to accomplish in your life?
2. Who are the people that matter most to you?
3. What do you want your legacy to be?
4. What are your main concerns?
5. How do you plan to achieve your life's vision?

No matter where you are at in your life: Starting a business, running a business, selling a business, or retired, financial decision-making starts with the answers to these questions. We can't plan and invest appropriately without knowing what the outcomes are that we are trying to achieve.

Of course, the financial aspects of selling a business are an important, but narrowly focused, aspect of post-business life families need to address.<sup>11</sup> Our hope and intention with this report is to provide a framework for clarifying the financial considerations in order to enable families to focus more on other, more pressing, issues. We hope it was successful in that regard, and, as always, we hope you find it useful for meeting – and exceeding – your goals.

<sup>10</sup> Investment strategy insights: How should investors deal with lump sums?, UBS Chief Investment Office GWM, 10 February 2019.

<sup>11</sup> UBS Investor Watch Report "Who's The Boss," February 2018.





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