

“HONEY, YOU DON’T UNDERSTAND”

Why Women in Divorce Understand Far More Than Their Husbands Imagine About Asset Management, and What They Can Do to Make Those Assets Pay Off

As asset managers, we are often asked why we have placed such an emphasis on developing a role as financial advisors to women during and after divorce. The answer has to do with differences in the ways that men and women approach the investment process, differences magnified by the stress and distress of divorce.

Culturally, men are supposed to know it all, no matter what it is – even when they don’t know anything about it. As a result, they often let their egos get in the way of investment decisions. When we’re counseling a husband and wife, a husband will often say something like, “Honey, you don’t understand what a PE is. Let me explain it to you.” Often, his explanation is wrong.

By contrast, we find that women are better listeners and learners. Unfettered by the machismo factor, the pressures of societal expectations or the cultural predispositions that often drive men to take imprudent risk, women tend to approach investment decisions more rationally.

Investment requires flexibility. Men tend to make decisions and then try to rationalize them. Women are more willing to reevaluate their decisions. Women are better delegators of management, while men want more control. In a volatile market, women are more likely to remain calm, while we get a lot more phone calls from the men. The men see investment as a sprint. The women see investment as a marathon.

Certainly, these are broad generalizations. With the division of labor that usually occurs in a marriage, however, especially once there are children, women do tend to have less experience in financial affairs. Perhaps because of this, we find that women during and after divorce are a little less confident about their ability to take on this role. They show more willingness to acknowledge their limitations and to recognize that they can make mistakes.

After divorce, it can take several years for the client to grow into this role of being responsible for financial decisions. The financial advisor's role must be one of mentor and counselor, to introduce and expose the investor to financial management at a gradual rate. We find that a divorced woman with little previous financial responsibility develops very good management skills within a couple of years. It's a rewarding process for us as well as for the investor.

Requirement #1: The *Independent Financial Advisor* --An Advocate, Not a Sales Person

Divorce proceedings are often public record, and women more than men are the target of aggressive sales practices at a time when their lives are in flux, they're inundated and they're having trouble filtering through financial information on top of all the other things going on in their lives.

One of our customers, with a net worth in the \$4 million range, was approached by a broker recommending that she invest \$1 million in several hedge funds. That is not a product prudent or a suitable recommendation for someone with that net worth. It might be appropriate for 10 percent of your investment securities – MIGHT be. A hedge fund is a high-risk investment – not necessarily as a result of the investment itself, but due to its

operating in an unregulated environment. Financial reporting is not subject to regulatory oversight. There are substantial risks for fraud.

The broker told her about the attractive features of the hedge funds and downplayed the downsides of such an investment. While hedge funds are appropriate in small doses for certain investors, the dollar amount has to be right, it has to fit in an overall investment strategy, manager due diligence should be done by a professional, and the investor needs to understand the risks involved.

We've seen examples where a divorcée or widow who is feeling vulnerable puts 100 percent of her faith and portfolio into someone who is not competent or honest and ends up with variable annuities. This results in a lack of diversification, illiquidity and excessive fees, especially when the variable annuities are sold by a broker or insurance agent.

We've had our clients approached by insurance sales people for long-term care policies or variable life insurance, and when we've looked into those investments, they were not the best quality.

The divorcée needs not a salesperson, but an advocate — someone watching out for her best interests and helping her separate responsible salesmanship from cheap hustle.

A broker works on a commission basis, where his or her income depends on buying and selling. An independent financial advisor should work on a fee basis, in which there is a periodic fee based on the amount of assets under management. This arrangement provides a far better alignment of interests between advisors and customers.

A broker's advice can also be influenced by what the brokerage wants to sell. With few exceptions, full-service brokerage firms have investment banking operations, from which they make *the majority of their money*. A company that needs money for a new factory or headquarters building – a company like, oh, say, Enron – doesn't borrow it from Wells Fargo. It goes to an investment bank to raise capital, by selling shares through its brokerage operation. While your broker is probably an ethical and competent person, there is a potential conflict of interest that does not exist with an independent financial advisor.

Requirement #2: A Team Approach

The asset-distribution and management issues stemming from divorce are complex. There are tax issues. Estate-planning issues. It's a situation in which the investor requires investment strategies tailored to the unique legal, accounting, tax, estate and asset-distribution planning that divorce entails.

A competent investment advisor plays a sort of investment-quarterback role in a team environment with the client's accountants, attorneys and in some cases insurance professionals to establish a plan that is well coordinated and works well for the divorcee's new situation. That's true not only on the investment side but in making decisions about housing and the amount of mortgage to have, the amount of income to try to generate from the portfolio and other sources, and often some very rigorous cash-flow planning depending on particulars of the alimony and other financial-settlement aspects of the divorce.

Divorce is a downsizing, often involving the sale of one big house and purchase of two smaller homes, with an increase in mortgages at a time of decrease in income and

a need for immediate liquidity to pay for professional fees, re-assigning of beneficiaries on life insurance and IRAs and wills. All these things require a collaborative relationship between a divorcee's investment advisor and her other professionals.

It is helpful to begin establishing these relationships during the divorce process, because there are often opportunities to negotiate settlements that are more appropriate in terms of taxes and assets. One of the divorcee's first steps is to independently develop – with help from investment, tax and legal advisors – an idea of what she needs coming out of the settlement.

Requirement #3: Asset Management Starts During the Divorce, Not After

During the divorce is where it's important to get advice from a financial professional to make sure the financial arrangements being contemplated are realistic to meet the divorcee's objectives. While the man is more likely in a position to get a new job or start a new business, the woman often needs to concentrate on protecting her income. If it's a negotiated settlement with alimony, the alimony should be indexed to inflation. Or it might include life insurance on the ex-spouse, or income-producing assets – the strip mall vs. the municipal bond portfolio.

Often in a divorce, the man retains the earning capability and gets the business while the woman gets the house, vacation cottage and stocks. The business can raise prices and raise his salary, so his income is thereby indexed to inflation. Will the woman's assets be able to produce needed income *and* grow at the rate of inflation?

Many financial plans fail to recognize inflation's long-term effects. A person may start with an income of \$100,000 from a \$1 million portfolio returning 10 percent. If

inflation is 3.5 percent, however, the purchasing power of that \$100,000 will be down to \$50,000 in 20 years.

As part of a divorce settlement, a trust may be established to provide income for the divorcee, with the remainder beneficiary being the children from the marriage. Trusts come in many flavors. We might, for example, suggest that the trust be a “unitrust,” one which distributes a percentage of the total principal balance each year, vs. one that just distributes income from the account. This allows for greater investment flexibility or it can enable the divorcee to have better protection of her income stream from inflation over a long period of time.

When the divorcing couple has dramatically different tax rates, the investment advisor can coordinate with the attorneys and accountants to take advantage of splitting assets in a manner that reduces the wife’s tax burden, or the couple’s combined tax burden. If the husband was a high tech investor, for example, we might see that he gets a parcel of property that carries a huge capital gain, while the wife might get a piece of property with a narrower margin between original cost and current market so less gain is built in when the asset transfer takes place.

Questions of custody also bring their own unique requirements for an investment advisor, the education-planning and other needs associated with children. Investment strategies are an integral part of how the expenses and obligations associated with each child are plotted out.

The assumptions made during divorce negotiations need to be reasonably conservative so that the divorcee has financial security to meet her income needs as she emerges from the divorce. The worst position she can be in is having to invest too

aggressively to try to stay ahead, or in a financial pinch where she has strong financial pressure to remarry or greatly compromise her lifestyle.

Requirement #4: Choose the Right Investment Advisor

How do you find the right investment advisor? First, as always, you should look for someone whose services are based on fees vs. commissions, and one with the experience and expertise to handle the complexities surrounding a divorce. Look for an advisor who is well respected not only by his or her clients, but *also* by other professional-service providers in their community. A good salesman may be able to fool his clients.

Ask your professional advisors, lawyers, accountants, bankers (but not an insurance agent or stockbroker), and often business people in the community. These people are a good screen. They know quality advice when they see it. Divorce lawyers and CPAs are a particularly good source of reference, because they work in this environment. You wouldn't choose your doctor based on an ad in the yellow pages but on the recommendation of another doctor that you trust. Similarly, in the financial community, a starting point is to see who the other professionals are recommending, and ask them why.

And of course, if you know people who have gone through complicated divorces where specialized investment counseling was needed, they're a good source as well.

Having identified candidate professionals, meet with several. Look at qualifications, tenure and experience of the individuals. If they don't have an advanced degree in business or financial professional certifications – i.e. CFA or CPA – then walk

away. Meet with several and make sure that there is a good feeling or fit between you. This is someone you will work with over a long period of time.

A good question to ask: What is the rate of turnover in the financial advisor's client base? It should be close to zero. It's a difficult question to verify, but if you can get an accurate reading on this, it's a good way to know whether they're service oriented; or whether they are sales oriented, attracting clients, burning them up and looking for new ones.

Ask about confidentiality. Divorce is a time of splitting friendships as well as marriages, with risks of rumor and public exposure. Make sure you have the utmost confidence that you are dealing with people who will treat your situation with the strictest confidentiality standards.

No matter how smart you are, how capable and financially savvy, divorce can cloud your decision-making process. This is the time to bring an objective and capable investment advisor into the mix. It's a time when the investor is vulnerable to predatory practices and needs an *independent* investment advisor. And, quite frankly, it's a time when we find that women often make better investors than men, and a good investor is a joy for any investment advisor.

Wally Obermeyer is founder and President of Obermeyer Asset Management Company, an Aspen, Colorado investment advisory firm that serves a national client base of high-net-worth individuals, corporations and foundations. In addition to his advisory practice, Wally has broad financial and business management experience, including management of the family ski apparel business and a hydroelectric generation company. He holds an MBA from Harvard Business School and a BA from Harvard College with a major in Economics. Wally resides in Aspen, Colorado.

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