Sentinel Trust Company

On Watch

SEPTEMBER 2014 | VOLUME 5, ISSUE 2

Best Habits of Private Investors

D. FORT FLOWERS, JR., CFA
Chairman and CEO

In This Issue:

I was going to title this article "The Worst Habits of Private Investors," but that seemed way too negative, as most investors only need a bit of fine tuning in their approach; therefore, I thought it more appropriate to discuss some of the best habits of sophisticated investors.

Story continued inside.

They understand risk and avoid taking unnecessary risk

Successful investing requires taking risks; the best investors carefully choose the risks they take. Sophisticated investors consider how much risk they can take, and then they allocate that risk throughout their portfolios so as to bring them the best risk-adjusted return.

For each investment, they consider the potential reward if things go as or better than expected as well as considering various adverse outcomes that might occur. Adversity can come in the form of issues specific to the investment, such as poor management decisions and execution, or it could be factors outside of management's control, such as unexpected economic conditions. An in-depth understanding of potential upside and downside, as well as the factors that will cause outcomes to be different than desired, makes for better investment decisions.

Sophisticated investors consider risk not only at the individual security and investment strategy level, but they also consider how various types of investments will perform in various economic scenarios (e.g. rising and falling energy prices, interest rates, inflation), so that their portfolios are not overly susceptible to any particular economic environment. This consideration leads the best investors to have portfolios that contain a diversified collection of assets and asset classes.

So, the best private investors are thoughtful throughout the investment process, from the initial development of their strategic investment plans to the detailed execution of those plans.

They look at potential investments with healthy dose of skepticism

The easiest investment products to sell are those that have a recent track record of extraordinary performance (e.g., tech stocks in 1999 or real estate in 2006). After an asset class has had an extraordinary run, people who have missed it are anxious to join the success, and those who enjoyed it often desire more of the same. Unfortunately, investment products are created much closer to the end of outperformance than to the start, and investors who aren't skeptical of the timing often end up with significant disappointment. Sophisticated investors are therefore skeptical about the timing and the motivation of those showing the opportunities.

Another situation where sophisticated investors remain skeptical is when they are led to believe that they are part of an exclusive group being shown an opportunity. There are cases where an investor brings much more value to an opportunity than just cash, such as experience in the field or a network that can help bring business; however, in many cases "exclusive opportunity" just means that no one with more sophistication is interested in participating.

They take taxes into consideration

The most serious drag on investment performance is almost always taxes. Many think that all they need to do is follow the lead of sophisticated institutions (large endowments, foundations, pension plans, etc.) and invest in a similar way. Obviously the primary difference between those institutions and individuals is the taxes that are owed on investment returns and transfers to descendants.

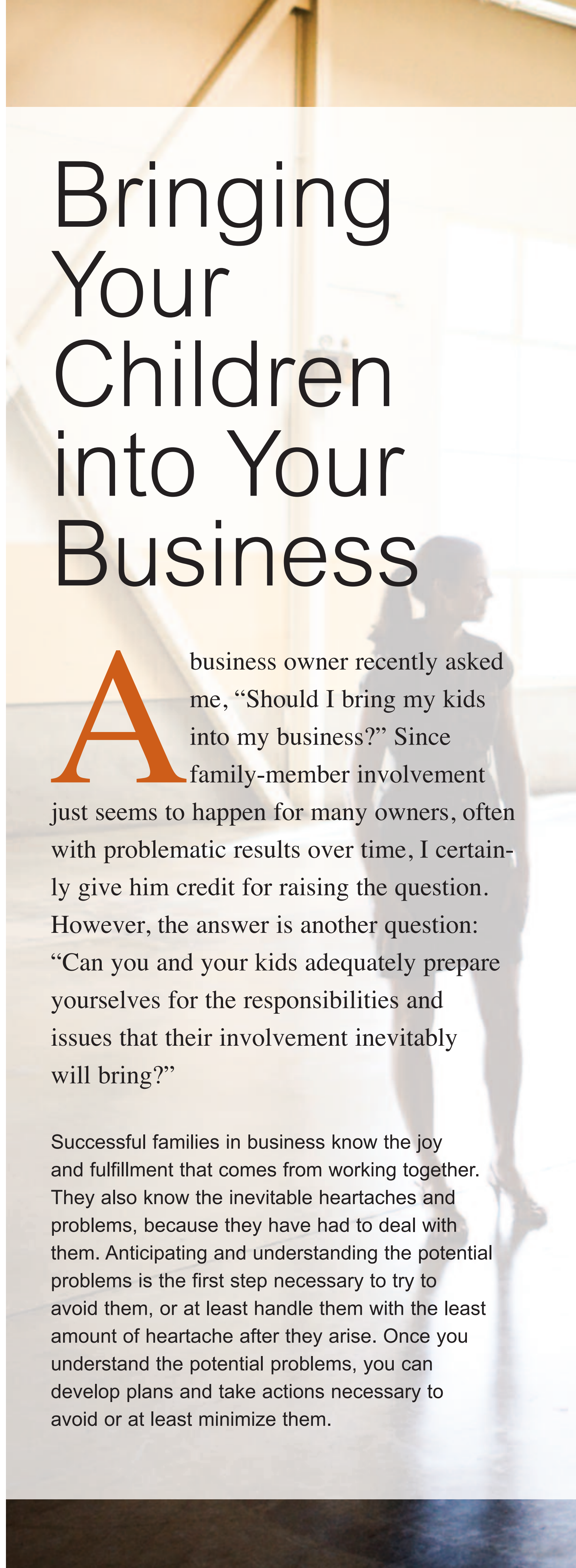
Sophisticated investors consider the after-tax impact of their investment portfolios throughout the investment process, all the way from asset allocation and manager selection within asset classes to individual security selection. Careful consideration of tax impact can bring substantial additional after-tax return without impacting risk.

They take steps so emotions don't rule the day

Emotions are almost always the worst impediment to successful investing. It is always emotionally difficult to buy securities when markets are crashing or to sell when markets are soaring – yet those often turn out to be the best long-term decisions.

Successful investors recognize emotionally difficult situations and create long-term plans that will help them make good decisions in spite of the situation. They formalize their investment plans so that they have rules they can stick with in all market conditions. They consider ahead of time how they should react when things go outside of their expectations (whether better or worse). By considering situations that may develop before they occur and having a plan for dealing with them, sophisticated investors can make good long-term decisions in times of high emotional stress.

So, the best private investors are thoughtful throughout the investment process, from the initial development of their strategic investment plans to the detailed execution of those plans. Of course, they also actively monitor compliance with their plans. They think ahead about the impacts of potential outcomes, can control their emotions based upon their planning, are skeptical of product offerings, and consider the impact of taxes. Simply flip these around to identify the worst habits of private investors.



Bringing Your Children into Your Business

A business owner recently asked me, "Should I bring my kids into my business?" Since family-member involvement just seems to happen for many owners, often with problematic results over time, I certainly give him credit for raising the question. However, the answer is another question: "Can you and your kids adequately prepare yourselves for the responsibilities and issues that their involvement inevitably will bring?"

Successful families in business know the joy and fulfillment that comes from working together. They also know the inevitable heartaches and problems, because they have had to deal with them. Anticipating and understanding the potential problems is the first step necessary to try to avoid them, or at least handle them with the least amount of heartache after they arise. Once you understand the potential problems, you can develop plans and take actions necessary to avoid or at least minimize them.

So, here are some **questions** that you and your children should discuss before you make the decision, along with some hints about how to begin framing possible actions to resolve them:

- **Can they bring skills and experiences that will be valuable to the business?** Perhaps they can develop educational and work backgrounds elsewhere so that they can bring something of value with them besides their last name.

- **Will they be able to earn and keep the respect of the other employees?** If they have proven themselves elsewhere and can develop the leadership and interpersonal skills to have appropriate relationships with their co-workers, they are more likely to be successful in your business.

- **Can they work productively together and with you?** Families can learn to communicate effectively, develop the skills to solve problems constructively, and agree to disagree yet still make decisions and maintain healthy relationships.

- **Can you and the kids evolve your parent-child relationship (and the kids evolve their sibling relationship) into relationships that are perhaps more appropriate in a business environment?** For example, although you may love your children equally, how will you (and they) respond when they don't perform equally in the business world? Can the kids leave behind childhood rivalries and work together?

- **How will compensation be determined?** And, how might the kids' relationships be affected if their compensation is equal but their contributions to the business are unequal?

- **How will you handle the situation if one of the kids is not successful in your business?** It will be helpful to have an understanding of expectations and consequences before a problem arises.

- **If the kids are successful, are you willing to hand off responsibility, authority and ownership to them?** Will these be given equally to them even if their contributions are unequal? Will you be able to stay out of their way and avoid undermining their authority as you give it to them?

- **How will your and the kids' spouses view the answers to these questions?** Can spouses accept the family's resolutions of these questions or will they develop resentment and mistrust due to what they see, but may not fully understand or appreciate.

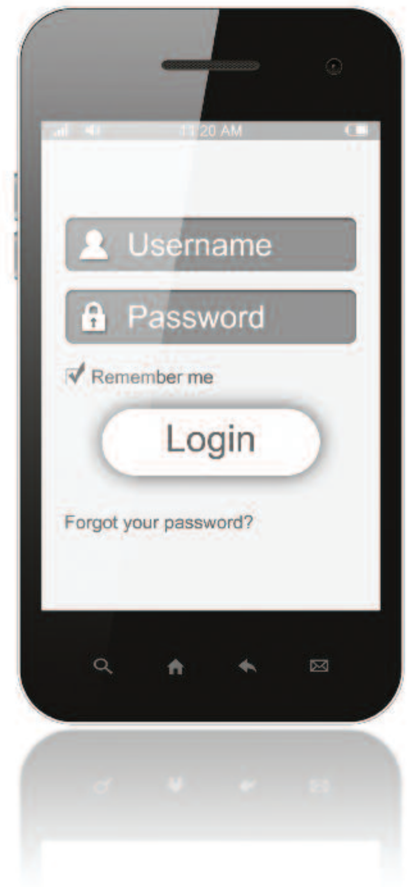
Some of these questions will seem downright scary and not all of the answers will be obvious. That's ok. It will take time and energy by all of the family members to work through these types of issues. But believe me, investing the time and energy early in the process of involving the kids, and before problems develop, is far easier and less stressful than resolving problems after they arise.

So, the better first question you should ask is, "Do my kids and I have the willingness to work together to anticipate issues and then seek (and accept) answers that will position the business for long-term success and the family for long-term harmony?" If you and the kids can answer "yes" to this question, and then follow through with this commitment, you are far more likely to have a successful outcome if the kids come into your business.

ROSS W. NAGER, CPA
Of Counsel

Estate Planning
For Digital Assets

Most likely, you are awash in digital information. It can be daunting to keep track of it yourself. Imagine how hard it would be for your family and executor to find, access and sift through it if you're not around.



ANDREW B. SMITH, J.D.
Vice President and
Senior Relationship Officer

If something happens to you, would your family (or executor) be able to find your assets and timely pay your remaining bills? Historically, an executor could build a pretty good list of a decedent's assets and liabilities by monitoring the mail for bills and account statements, opening the safe deposit box, and searching desk drawers and file cabinets. A walk through the house would yield family heirlooms, photo albums and other items of sentimental or financial value. Today, many of these things are digital, with no physical indications of their existence. Even if your loved ones can find them, they may be locked behind impenetrable passwords.

The first step in planning for digital assets and accounts is to create a list of them and how they are accessed (website address, username, password, security questions, etc.). Examples include online bank and investment accounts, e-mail accounts, Paypal accounts, social networking profiles and messaging content, and airline frequent flyer accounts. List locations and access information relating to digital photos and videos and data backup services. Also list bills (and related access information) that are handled electronically, like credit cards and utilities. Finally, list your electronic devices (computer, smart phone, tablet, etc.) and their passwords.

The second step in this process is to determine a place to store your digital inventory. Ideally the location would be accessible for frequent updates, but not vulnerable to misplacement or theft. An in-home safe may be a good option for a paper copy of your inventory. If you prefer to store your inventory electronically, there is a burgeoning industry of companies that provide this unique service. Websites like Legacy Locker and AssetLock store your photos, passwords, and other digital data for a monthly or one-time fee. These websites allow your executor or loved ones to access your digital data if you become incapacitated or die.

The next step is to think about who should be given access to this information while you are alive. Giving this information to your spouse or kids is like giving them the key to your personal Fort Knox. But, someone probably needs access to it if you become incapacitated. Similarly, you will need to notify your executor(s) about how to access your digital inventory if you die.

One approach might be to keep all of your usernames and passwords for all websites and accounts in a single electronic password vault like RoboForm. You then need to remember one password to access everything, making your life much simpler. Then, keep instructions on how to access the electronic password vault in your bank safe deposit box. Finally, create a way for your spouse, kids and/or executor to access your safe deposit box when necessary.

Most likely, you are awash in digital information. It can be daunting to keep track of it yourself. Imagine how hard it would be for your family and executor to find, access and sift through it if you're not around. Spending some time organizing this stuff will make things easier for you the next time you forget a password and for your family if you are no longer around.

Sentinel Trust Company provides custom integrated planning, investment, fiduciary and administrative solutions to affluent families and their closely held businesses and entities.

Founded in 1997 as the successor to two 40-year old, investment-focused family offices, today Sentinel offers the stability of an institutional firm, the entrepreneurial spirit of a young firm, the personal feel of a family office and the in-house technical skills of independent planning and investment management firms.

Sentinel Trust Company

Contributing to this issue:

Anthony J. DeToto

D. Fort Flowers, Jr., CFA

Lissa Gangjee, J.D., CFP®

Ross W. Nager, CPA

Andrew B. Smith, J.D.

Bruce L. Swanson, Ph.D.

For additional information about the topics presented in this newsletter, or to be placed on our mailing list for future editions, please contact Anthony DeToto at adetoto@sentineltrust.com or call 713.559.9578. You can find electronic copies of our past quarterly newsletters at www.sentineltrust.com/publications/on-watch/.

2001 Kirby Drive, Suite 1200

Houston, Texas 77019-6081

713.529.3729

www.sentineltrust.com