

{ Convergent 10 Symposium }

Last month, Convergent Wealth Advisors hosted its annual *Convergent 10 Symposium*, an event designed for families and family offices managing over \$1 billion in wealth. The audience enjoyed an elite roster of speakers, including:

- Willem Kooyker, Founder and Chairman of Blenheim Capital Management
- Dr. Peter Linneman, Professor of Real Estate, Finance, and Public Policy at the Wharton School of Business at the University of Pennsylvania
- Jonathan Blattmachr, former head of the trust & estates practice at Milbank, Tweed, Hadley & McCloy LLP
- Bob Levy, Chairman of the Cato Institute
- Patty Stonesifer, Chairwoman of the Smithsonian Board of Regents and former CEO of the Bill & Melinda Gates Foundation
- Liz Ann Sonders, Chief Investment Strategist for Charles Schwab and Co.
- Dan Och, Chairman and CEO of Och-Ziff Capital Management

We thought we would share some of the themes which emerged from the Symposium. Please keep in mind these views represent those of the speakers and not necessarily those of Convergent Wealth Advisors.

THE MACRO PICTURE: ARE THE POSITIVE SIGNS A REALITY OR ARTIFICIALLY INFLATED?

While our speakers opined on a wide variety of topics, many shared their market prognostication which reflected a unanimous tilt towards a positive continued recovery in the world markets. Highlighting the bullish case over the intermediate term, our speakers commented:

- We have already witnessed a V-shaped recovery as 4Q GDP 2008 was down nearly 6% quarter over quarter and 4Q GDP 2009 was up nearly 6% over 3Q GDP. That is an extreme positive swing.
- The recent decline in initial unemployment claims has reached levels similar to those reached at a comparable point during the 1983 recovery phase, providing some support for the case that this recovery may be following a normal pattern. While there are many differences between the macroeconomic backdrop in 1983 versus today favoring the 1983 period, it is important to note that despite the lower debt levels in the early '80's, debt servicing costs were much higher given double digit interest rates.
- Corporate cash to business capital spending ratio is at a record spread, indicating there is pent up demand for capital expenditures.

- It appears we are in a *catch up* phase for the economy. With a 4% decline in GDP peak to trough (December 2007 through August 2009), we should have expected a 4% decline in payrolls by historical standards, yet we experienced nearly a 6% drop in payrolls. On a relative basis, the drop in jobs was almost 50% more than was justified. As such, we should expect increases in industrial production, inventory replenishment and employment to continue.
- Recent increases in yields indicate strengthening of the economy. Three other periods in US history experienced a similar increase in yields and stock prices, and they all involved deleveraging periods.
- In March 2009 the US markets experienced a period of 20 year rolling returns during which bonds outperformed stocks. This happened in the '30's and '40's and each period led to five years of subsequent stock outperformance.

However, despite making a strong case for a bullish outlook in the intermediate term, there are potential stumbling blocks, primarily excessive leverage, that could cause prolonged volatility and perhaps a square root recovery.

THE BULLS ARE RUNNING IN EMERGING & COMMODITY MARKETS

It was noted that we are in the midst of a secular bull market in commodities primarily due to demographic trends in the emerging world. While the discussions covered an array of countries and commodities, the following points are some of the highlights of the proffered rebuttal for those who doubt China:

- Q: *Is China's growth primarily export-driven with minimal internal demand?*
A: China should sell over 17 million cars this year, far surpassing US sales. Increasing sales of cars and other manufactured goods to China and other emerging economies should provide substantial support to the shortage of natural resource theme for years to come.
- Q: *Is China funding the construction of buildings that remain vacant just to keep people employed?*
A: High vacancy rates have been typical of Chinese plans; past and present. This trend is not comparable to the reckless overbuilding in the US that had no basis in demand. To the contrary, this development represents the foresight of the central planners who understand the need to build for future demand to minimize the probability of social unrest. This pattern has been repeated in China for decades.
- Q: *Has the Chinese government taken away the credit punch bowl?*
A: While the Chinese have recently tightened credit by increasing reserve requirements and down payments on residential real estate, it is important to note that most Chinese either apply down payments significantly in excess of the requirements or they pay for their homes in full.

GLOBAL INVESTMENT LANDSCAPE: WHERE ARE THE OPPORTUNITIES?

During the Symposium, the view was expressed that the global markets are not currently synchronized, potentially creating a variety of opportunities around the world. The risk environment is also more challenging.

- Today, we are witnessing the rare occurrence of potential opportunities abounding both in strategies normally dependent on growth (Mergers & Acquisitions and Recapitalizations) while simultaneously seeing opportunity in distressed and dislocated assets.
- Long/short equity is attractive, particularly in a sideways market and where many long managers are focused on not missing their benchmarks.
- The mortgage-backed and securitized markets are very deep with significant dislocations, as well as high barriers to entry for new managers coming into the space.

REAL ESTATE: DEAD OR ALIVE?

Our real estate expert noted that a stronger than expected economic recovery should have a positive impact on real estate over time. The highlights supporting a bullish outlook for real estate include:

- The lack of new construction in recent years and lack of recent household formation make multi-family residential and, further down the road, single family homes, attractive. Above average rates of unemployment for the 20-24 year old cohort has left many young adults living at home. When jobs become available, those individuals will look to move out, likely into apartments.
- Various factors, including population growth (approximately 3 million per year, requiring 1.2 million more jobs per year) and productivity growth (averaging 4% over the last two years) will force economic and real estate development. At a bare minimum, the US needs 1% of GDP growth every year due solely to population growth; yet we have been flat from 2008 through 2010.
- Multi-family investments may be a good hedge against inflation given fixed rate mortgages and an income stream that will grow with inflation. The suggestion was made to focus on smaller properties where the big “New York” private real estate funds will not fish.
- Land is attractive. Developers are looking to add land to their inventories lately. Investors looking at land need to be prepared to hold it for a long time.
- Office space will be slower to recover, as many tenants have empty desks to fill before they will need additional space.
- Hotels are a challenge, because it is nearly impossible to get debt. They are a raw bet on the economy and have a lot of operating leverage, which will cause volatility.

THE ESTATE PLANNING CONUNDRUM OF 2010

In the area of estate planning, our speaker focused his discussion on the various issues and challenges currently facing estate planners.

- Many of the estate tax laws enacted by the Bush tax cuts in 2001 will sunset at the end of this year and without further action by Congress will revert back to the pre-Bush levels. Most current wills were not written for this type of environment and may subject

estates to interpretation of how transfers in 2010 may be considered in future years (e.g. will GST transfers in 2010 count against the lifetime exemption?).

- It is possible, though improbable, that Congress could pass legislation and make any changes retroactive to the start of 2010 (not without challenges to the constitutionality of such a move).
- Other unique issues about 2010 include the fact that there is no step-up in basis for assets passed as a result of death in 2010. Questions still remain as to whether a step-up would apply if assets are held into 2011.

CONCLUDING REMARKS

As you can ascertain, the tone from most of the speakers was relatively bullish; especially in their areas of interest and expertise. Timeframes to capitalize on potential opportunities varied and all expressed concerns regarding the risks posed by mounting debt levels here and in the rest of the developed world over the long term. Many of the underlying themes embedded in our asset allocation and manager selection choices are consistent with the opportunities and risks discussed during the Symposium. In addition, their comments regarding uncertainty in markets made it clear that our work in risk management, asset allocation and manager selection can and should make a difference to results experienced by our client portfolios, both in seeking to minimize risk and capturing potential opportunities.

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