HKUST BUSINESS SCHOOL 香港科大商學院 WORLD CLASS IN ASIA | Tanoto Center for Asian Family Business and Entrepreneurship Studies 陳江和亞洲家族企業與創業研究中心

Luncheon Talk on

Navigating the New Realities of Managing Family Wealth in a Volatile Global Environment

Tanoto Center for Asian Family Business and Entrepreneurship Studies

The Hong Kong University of Science and Technology

Hong Kong

3 March 2016

Contents

Organizer

The Tanoto Center for Asian Family Business and Entrepreneurship Studies at the Hong Kong University of Science and Technology is a leading research center in the burgeoning field of Asian family business and entrepreneurship studies. It aims to bridge the knowledge gap between academics and practitioners as well as policymakers in all of its programs and activities. Recognizing the multi-disciplinary nature of the field of family business and entrepreneurship, the Center collaborates with various departments at HKUST and institutions around the world to organize academic and industry symposiums and roundtable events, conduct and publish top-quality academic research and articles in leading journals and newspapers, provide both tailor-made and open-enrollment training programs, write and teach cases on Asian family businesses and entrepreneurship. More information may be found at http://www.afbes.ust.hk/.

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BNY Mellon Wealth Management is a leading wealth manager, and was named in 2015 by Family Wealth Report as the top National Private Asset Manager and top Private Bank serving Family Offices. Barron's ranked it the 7th largest U.S. wealth manager in 2015. The firm has more than two centuries of experience in providing services to clients who today include financially successful individuals and families, their family offices and business enterprises, planned giving programs, and endowments and foundations. It has $191.8 billion in total private client assets, as of December 31, 2015, and an extensive network of offices in the U.S. and internationally. BNY Mellon Wealth Management, which provides investment management, custody, wealth and estate planning and private banking services, conducts business through various operating subsidiaries of The Bank of New York Mellon Corporation. For more information go to bnymellonwealthmanagement.com or follow us on Twitter @BNYMellonWealth.

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Program Schedule

Navigating the New Realities of Managing Family Wealth in a Volatile Global Environment

Date: **Thursday, 3 March 2016**

Venue: **Salons III & IV, Mezzanine Level, Grand Hyatt Hong Kong**
1 Harbour Road, Hong Kong

Time: **12.00pm – 12.30pm:** **Registration**

12.30pm – 2.30pm: **Luncheon talk**
Leo P. Grohowski, Chief Investment Officer
BNY Mellon Wealth Management

About the Speaker

Leo Grohowski is chief investment officer of BNY Mellon Wealth Management. He leads all investment strategy and investment management functions for the wealth management organization.

Mr. Grohowski joined BNY Mellon in 2007 and has more than 30 years of industry experience. Previously, he was with US Trust, Bank of America, where he was chief investment officer, responsible for investment solutions and the end-to-end investment process, including portfolio management and investment strategy for Private Wealth Management clients. Prior to his role at US Trust, he was the chief investment officer for Deutsche Bank in the Americas, overseeing more than $250 billion in assets. From 1999 to 2002, Mr. Grohowski was chief investment officer of Deutsche Bank Private Banking, serving as chairman of the Global Markets Strategy Committee and Domestic Investment Strategy group, and head of Investment Products and Services for the DB Alex Brown unit. In 1996, Mr. Grohowski joined Bankers Trust where he served as a senior trust investment officer of the Private Bank and head of the U.S. Investment Strategy group. He was with HSBC Asset Management from 1988 to 1996 and was named chief investment officer in 1993, after heading the U.S. Equities group from 1988 to 1993.

Presentation Summary

Mr. Leo Grohowski, Chief Investment Officer, BNY Mellon Wealth Management

The Tanoto Center for Asian Family Business and Entrepreneurship Studies at HKUST recently addressed issues related to managing family wealth in the face of increased volatility and uncertainty in the global markets. The talk was amongst a few events that the Center organizes to bridge the knowledge gap between academics, practitioners and policymakers and to share the Center's research findings on topics of concern to family businesses.

Leo Grohowski, Chief Investment Officer of BNY Mellon Wealth Management, spoke to a select group of family business owners and family office professionals from household names such as Lee Kum Kee, Shun Hing Group and Sino Group, together with our dean-designate Professor Kar Yan Tam and other faculty members. Grohowski leads all investment strategy functions within the firm, which manages approximately US$192 billion in private client assets. Below summarizes Grohowski's presentation.

Time to Buy?

A slowdown in the Chinese economy, normalization of U.S. interest rates, and a sharp decline in oil prices have fueled fear and, at times, panic in the markets. Some families are plugged into the news and have grown very concerned and worried.

Various studies show that families are in a better position to leverage their long-term orientation. Unlike financial institutions which look at daily performance, families often have a longer investment horizon extending over years. Grohowski said, "Energy and oil today give us a better entry point. We have to be careful about short-term forecasts. I know a company which forecasted that oil would be US$200/barrel but now dropping it to US$20/barrel, not too long ago."

Grohowski advised families to seek suitable strategies and not products. He noted that many clients are looking for yield in this low rate environment and shared an example of a strategy created to meet that need. "In spring 2014, people were concerned about the Euro zone and the Greek debt default. With European banks facing pressure of deleveraging and recapitalization, it was a good opportunity to provide capital to some of non-high-grade-rated companies that could not get credits through banks. This global credit alternatives strategy provided a return of about 10% in 2015 for our clients."

This, however, requires families to take calculated risks. The development of timely strategies often means taking advantages of asset prices when headlines say the contrary. "Markets are discounting mechanisms and so far this year there is bad news discounted in these markets," said Grohowski. "Very often it makes sense to invest from the bottom-up when news from top-down is not always pleasant."

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Global Outlook

In 2016, Grohowski expected sustainable growth amid persistent volatility, rising interest rates in the U.S., divergent monetary policies of central banks worldwide, a strong dollar, stabilization of energy prices and modest equity gains. He estimated that global GDP will grow by 3% in 2016, slightly less than the IMF forecast of 3.6%.

The manufacturing sector in both the U.S. and China is struggling. The issue looms larger with China as it faces an active transition from a manufacturing-based economy to a service economy. GDP in the U.S., Grohowski estimated, will continue to grow at around 2.2%. Employment has shown a strong improvement and inflation remains contained. Business and consumer confidence has risen, while home prices have started to appreciate. Both of these trends bode well for consumer spending as evidenced by an improvement in retail sales.

Grohowski added, "Economic growth has been relatively slow because households have been forced to clean up their balance sheet, including the mortgage loans and consumer credits."

Divergence in the Fed tightening and the more accommodative monetary policies of other central banks has driven a stronger dollar. Grohowski cautioned, "There is a very crowded long-dollar trade in place today, but the dollar's appreciation will not be as rapid as in the past 12 months."

Global inflation has been low but not non-existent. In China, consumer prices moved up by about 1.8% year-over-year. Families need to think about preserving buying power. Grohowski remarked, "Every family has its own inflation rate. Families that are providing education for their children have an inflation rate over 1.8%, particularly if they are sending their kids to schools in North America. They need to find a way to hedge against the inflation."

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Opportunities with Equities and Diversifiers

Grohowski believed that a good number of equities in the world are supported by earnings. There are many markets that are trading at a very attractive level of valuation. "One of them is Japan, where negative interest rates have drawn a lot of investors into the market. There is GDP improvement in Japan and more importantly earnings are not yet recognized in the marketplace." Grohowski also mentioned an attractive yield opportunity in non-U.S. small cap companies.

Grohowski recommended a few "diversifiers" that help families smooth out volatility. One diversifier, long/short hedge funds, is not particularly popular when equity markets grew at 15-20%. As the market has gotten more volatile, the value of long-short exposure has become more helpful. "Investors have to be cautious of hedge funds," said Grohowski. "Only about 800 out of 10,000 hedge funds we analyzed can go through the second screen for due diligence. So families should be careful about investing in hedge funds, but not necessarily avoid them." Other diversifiers, Grohowski suggested, included absolute return strategies, managed futures and private equity investments.

Creating Your Family Investment Policy Statement

Making investment decisions can at times create conflicts amongst families. That is why clear decision-making mechanisms could help avoid such disputes. Grohowski said, "Every family should have an investment policy statement, and should have a neutral position associated with different asset classes. The statement is strategic and should guide tactical decisions for overweighing or underweighting a particular asset class. The statement should be driven by a 7 to 10-year forward view; the allocation of each asset class is based on a 12 to 18-month forward view. Families should also have a plan to keep on planning. Understanding investment objectives requires a great deal of discovery and insight, particularly as families grow and wealth starts to be handled multi-generationally."

The ability of a family to sit together and decide on such a policy, however, requires a lot more coordination and preparation than one could expect. A family office might be a useful structure here, and linking all these to the overall family governance system would be essential.

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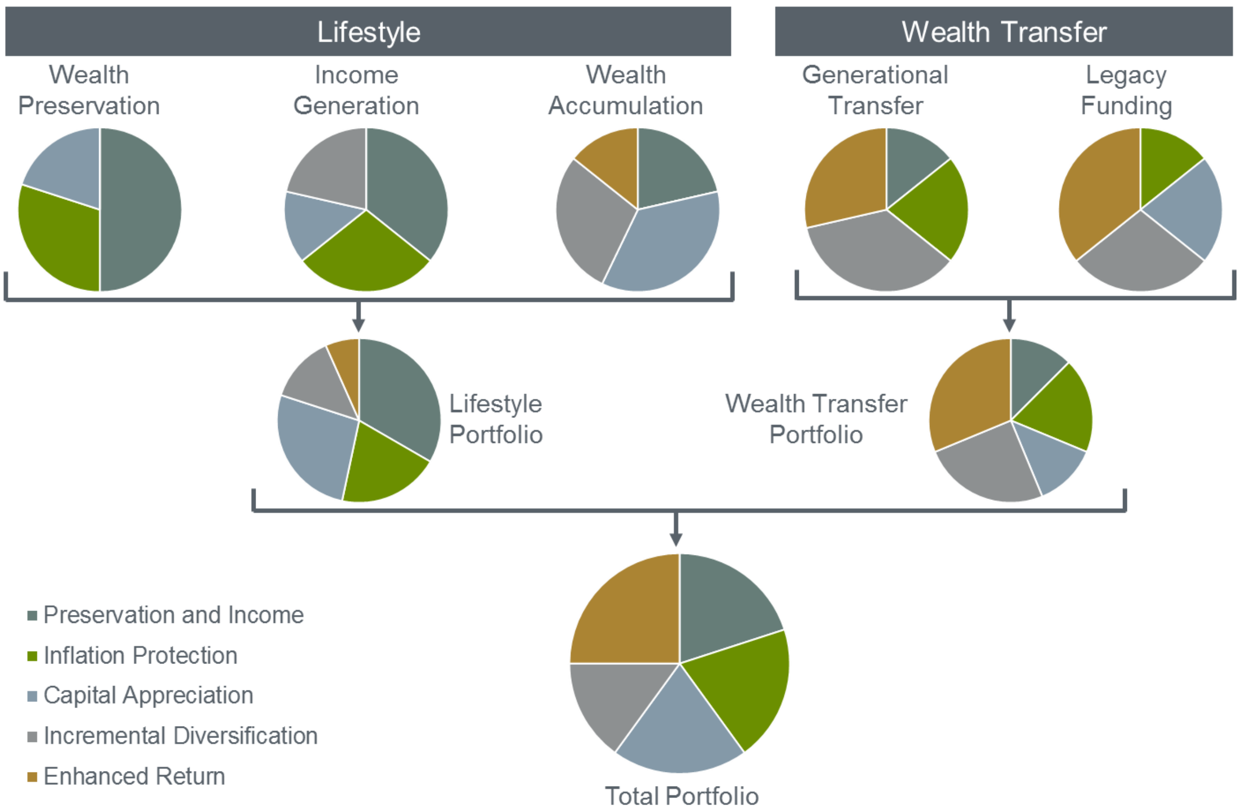
Lifestyle vs Wealth Transfer Portfolios

Many families treat their investment portfolio as a single one. Grohowski advised families to decompose their wealth into a "lifestyle portfolio" and a "wealth transfer portfolio". The lifestyle portfolio serves the purposes of wealth preservation, income generation and wealth accumulation, while the wealth transfer portfolio provides for generational transfer and legacy funding. "The lifestyle portfolio should be properly stress-tested for the probability of the portfolio declining 20% in any 12-month period," said Grohowski. "Once families get comfortable with that, they can consider investments that are less liquid such as private equity, which could lock up capital for 8 to12 years but yield a potentially higher return."



Source: BNY Mellon Wealth Management

Discipline, Due Diligence and Diversification

How can families manage and preserve wealth in this volatile era? Grohowski came up with the notion of 3Ds, namely discipline, due diligence and diversification: "The next few years require rigorous discipline. When a family has a target rate on a given asset class, it is very hard to rebalance and sell something that is not performing. Rebalancing is important, however, in such an environment. Families also need to do their due diligence. In the financial industry, short-term performance pressure often leads to poor decisions in hiring and firing managers at times. Families need professionals who can read those fund managers between the eyes, understand the investment process, and combine judgement with quantitative discipline. Finally, families need diversification. Sometimes these diversifiers are more expensive, but it ensures that you get the right solutions, not products, that drive revenues to the advisory firm or the advisor's pocket."

Key Dialogues from the Q&As

Q: What is your view of the U.S. presidential election outcome? How will this affect investors?

A: It is not affecting nor should it affect capital allocation. There is nothing called a Clinton portfolio or a Trump portfolio. At the sector level, however, this may have some implications. The healthcare stocks showed some responses when Hillary Clinton sent a tweet out on the sector.

Q: Interest rates will probably go up gradually. What vehicles do you suggest for hedging against the interest rate rise, bearing in mind that many family offices have their own risk tolerance?

A: The first thing to do is to know your duration, your maturity and your obligation to maturity. There is nothing wrong related to owning a security with a 5 to 10-year maturity range, providing a yield of 6 to 7%. You may think you are good with this yield but as the interest rate is up, the bond is printed 93 cents and you may not be very happy. In the next few years, it will be a "coupon minus" environment. This means most of the time you might have that coupon return minus the price. You will have to have a "safe deposit box" type of mentality, close your eyes and put these aside for the years to go to meet part of your liability.

Q: What would you say about sustainable investing? How do you work with families on sustainable investing across asset classes?

A: Sustainable investing, good governance, socially responsible investing mean something different to every family. It is about customized solutions. It is important to discover what is important to the family; how the family wants to make the impact; how the family defines the impact; and finally how to customize a portfolio around these. We can take the best investment thinking portfolio unconstrained and we can invest about 85% of this portfolio in solutions that are socially responsible in different ways. We are still working on the remaining 15%, in areas like high yield bonds and other specialized areas that are harder to get the exposure in a socially responsible way because a lot of those companies are not prepared for screening.

Q: As a chief investment officer, what keeps you awake at night?

A: Geopolitical risk is something we cannot quantify and forecast. When it comes to portfolio construction for families, it is to behave in a way that is consistent with their objectives. A lot of this means looking at intermediate or long-term, which is very hard to do today. Families should think in years, instead of weeks and months.

Photo Gallery

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