

# Why the rich won't lose money in this recession

By MARK VAN MOURICK

**Y**ou would think, after reading today's financial publications and talking with friends, that everybody got caught in the financial downturn of the last 20 months. Not the rich. However, the majority of people who invested on their own or through brokerage firms and financial planners are way down from their peaks in early 2000. That's because they all had the same playbook. It said diversify into small cap, big cap, value, growth, foreign, technology and healthcare stocks. It seemed to make sense, yet most people failed to realize that they still had all their money in one asset class – Public stocks.

Having an all stocks investment portfolio is like having just dessert for dinner, no matter how many different kinds you have, it's still not a well-balanced meal. Some investors were smart enough to also own an allocation of bonds, however, only short-term government bonds provided diversification from stocks. Most retail investor's bond holdings were long-term or medium to low quality credit (or both!). These kinds of bonds have a high correlation to stocks, offering no real diversification, and lost money in sympathy with stocks.

But not for the rich. They, or their experienced advisors, know that putting all of your money in one asset class is foolish. Despite the pie charts you read about in the money magazines, proper asset allocation also involves income real estate, development real estate, private equity, first mortgages, venture capital, hedge funds, natural resources, and foreign currency. Large portfolios, like the ones we manage, did great last year, and are further ahead this year. Sure, these asset classes require more work than a Morningstar mutual fund guide, but are still within reach of most investors.

The rich look beyond the 1990s for wisdom on their portfolio. Conservative income oriented families divide their assets equally between institutional quality income real estate (credit anchored shopping centers, office, apartment buildings and big box distribution centers) and medium term high grade (AA/AAA) municipal bonds. This combination provides a very stable 7 percent after tax income,



growing every year from rental increases. Yet the municipal bonds have full liquidity within three days, so they can have instant access to half the portfolio at any time. They use two to 10 year laddered maturates, instead of getting greedy with the high coupon 30 year bonds (which get crushed when interest rates rise).

Smaller accounts can duplicate this successful strategy with municipal bond funds and a diversified portfolio of high quality real estate syndications. Even multi-million dollar portfolios use syndicated real estate today to diversify further and benefit from professional management. Like any investment strategy, experience matters. We only use professionals with at least 25 years experience and an unblemished record. Out of 230 syndications, we have lost money on only three (which lead us to our 25-year rule). An income real estate/muni bond portfolio is the cornerstone for the majority of America's wealthiest families. It can work for you too, as the above strategy was unaffected by the recent economic downturn and will work in any market environment.

For those seeking higher returns and are less dependent on portfolio income, the rich have a different lesson – diversify broadly. They own a lot of stocks, but in a different form. Besides a long-term core U.S. stock portfolio, they also hold preferred stock (yielding 7 to 8 percent with upside) and importantly – private stock. Not pre-IPO startups, but stable cash flowing basic businesses like gas stations, hotels, assisted living centers, amusement parks,

radio stations, etc. In addition, they make money in real estate by building buildings and either holding the improved properties for long-term income or selling them to the conservative income investors (for a nice profit). They also make real estate loans, by providing first mortgage money on quality projects.

In addition, they also invest in hedge funds, which have done great in the last two years (the one I'm personally in was up 47 percent last year). Unfortunately, these investments have high minimums, often \$250,000-\$5 million, which prevents average investors from participating. But minimums have been coming down as these investments gain popularity, and some big brokerage firms will pool investors' funds to bring the minimums down further (ask your full-service broker about these). We believe hedge funds, particularly "market neutral" ones, will out-perform the general market for the remainder of the '00s.

Wealthy investors with this moderate risk growth posture, which are well diversified into the above investments, have been making 11 to 17 percent returns, mostly tax advantaged. You can too, but again you will have to go outside the narrow investment options (public stock, bonds, cash) of most brokerage firms and financial planners.

However, wealthy aggressive investors are doing even better. In addition to the above conservative and moderate growth investments, they steadily invest in multiple venture capital (pre-IPO) funds. And, for good reason. According to an Ibbotson & Associates study in 2000, venture capital funds have averaged 45 percent per year since 1960! Year-to-year returns are of course all over the board, so the smart money invests over multiple years with a variety of different firms. This way they are most apt to achieve that outstanding long-term

average. The best news is that recessions are ideal times to invest in venture capital because the weak companies have already gone out of business and the rest can be purchased at deep discounts. Here again, the investment minimums are usually high, but more and more firms are offering investors ways to pool their money to qualify for these funds.

Yes, the rich are different. They can hire the brightest advisors and diversify more broadly than the typical retail investor. However, with a little ambition and work, you too can have superior returns in all economic environments, just like the rich. **IM**

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