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Why the Rich Didn't Lose Money in This Recession

by Mark Van Mourick

You 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.

SEEKING BALANCE

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 thus 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.

LOOKING BEYOND THE '90S

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, offices, apartment buildings and big box distribution centers) and medium term high grade (AA/AAA) municipal bonds. This combination provides a very stable 7% after tax income, growing every year from rental increases. Yet the municipal bonds have full liquidity within three days, so investors can have instant access to half the portfolio at any time. They use two10-year lattered 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.

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DIVERSIFY BROADLY

For those seeking higher returns and who 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 7-8% with upside) and, importantly, private stock. Not pre-IPO start-ups, but stable, cash-flowing basic businesses like gas stations, hotels, assisted living centers, amusement parks, radio stations, etc.

In addition, the rich 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.

Additionally, the rich also invest in hedge funds, which have done great in the last two years (the one I'm personally in was up 47% last year). Unfortunately these investments have high minimums, often $250,000-$5 million, which prevent 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, who are well diversified into the above investments, have been making 11-17% 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.

THE AGGRESSIVE INVESTOR

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% 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. That way, they are most apt to achieve the 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.

Mark Van Mourick is the investment advisor and financial specialist to some of Orange County, California's wealthiest families. An avid mountain climber, international world speaker and media columnist, Van Mourick is also the author of one of the leading books in strategic investment and financial planning, "Cash Out, Cash In – How to Provide Sound Investments and Strategic, Financial Planning for the Ultra Rich" (Amazon, 2001) $125.00, 218 pages. Van Mourick is currently working on his new book "Investment Strategies for Today's Economy." For more information, contact Mark Von Mourick at (949) 363-8686.