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FINANCIAL TIMES

Risk is for the poor, and adventurers.

By John Authers
23 March 2007

We know that the rich are getting richer. We know that there are more of them. And we know that the fund management and banking industries are devoting huge resources to the new discipline of "wealth management". All this is clear enough from economic statistics, and from the most cursory look at the money management industry. The gloriously readable league tables of the world's wealthy produced by publications such as Forbes push it beyond doubt. What is still much less clear is how, exactly, the wealthy invest differently from others.

Generalizations about "the wealthy" and their demands need to be handled with care. According to Forbes, the world's five richest individuals are, in order: an US software entrepreneur, a successful US investment manager, a Mexican investor who controls a national telephone monopoly, the Swedish founder of Ikea and an Indian entrepreneur who has consolidated the global steel industry. Bill Gates, Warren Buffett, Carlos Slim, Ingvar Kamprad and Lakshmi Mittal are all very rich, but it might be dangerous to make too many generalizations about them.

However, the wealth management industry does seem to operate on the assumption that there are some generalizations that can be made about the wealthy. One is that they are keen to take on greater risks, not open to the public, in a bid to expand their wealth still further. Hedge funds and private equity, two sectors that have driven the markets for several years now and deservedly hogged much attention, are not directly available to normal retail investors. They are available to the wealthy, and central to the activities of private banks and wealth managers. Wealthy investors can also use various strategies, such as short-selling or the heavy use of derivatives, which regulators close off to most retail investors.

But do the wealthy really need this?

In theory, at least, a "wealth" manager should be able to ignore all the standard fund management concerns about beta and alpha - returns correlated and uncorrelated, respectively, to the market - and should also avoid benchmarking against average market returns. One of the many advantages of great wealth is that you no longer need to make a great, market-beating return to be wealthy.

Your only concerns should be, first, to avoid doing something stupid that actually loses your wealth, and second, to beat inflation. That suggests in turn that the most sensible strategy is what is now known as "absolute return" investing, where the cash is the benchmark to beat, and the key is never to lose money.

In other words, although the very wealthy can afford to take greater risks than others, it is probably more rational for them instead to be more conservative. They can take more risks, but they do not need to. It is those who have not saved enough for their retirement who might rationally start taking big investment risks. A number of recent surveys suggest that the wealthy do indeed behave this way. It appears that they are more, not less, conservative than the investing public as a whole. As a result, they may have played the recent sharp downturn in world markets rather better than everyone else.

Tiger 21, a New York-based group with 115 members, all of whom are "self-made" and have more than $7bn in investable assets between them, published a survey of its members earlier this month. They shifted their exposure to equities from 37 per cent in 2005 to only 30 per cent coming in to this year. Their exposure to alternatives did double, but only from a low base - from 4.5 to 9.5 per cent. Their average holding in cash was 9 per cent. And the alternatives they chose seem to have been designed more for the risk-averse.

Similarly, a study by Spectrem, a market research group, of US investors who had a net investable worth of at least $5m found that 43 per cent wanted the majority of their investments to have a guaranteed rate of return. This showed a change since 2003, when the desired allocation to guaranteed returns was only 29 per cent. As this was, in retrospect, a great time to scoop up bargains in the equity market, that may show that rich people are just better at calling the market, rather than fundamentally more risk-averse.

Their perceptions of the investments being proffered in their direction by the wealth management industry are intriguing. For example, 74 per cent describe hedge funds as "high risk" (as their name implies, they were once meant to be the opposite), while 61 per cent described private equity the same way. The very richest seem particularly cool on the attractions of hedge funds. A Spectrem survey of households with $25m or more to invest - high net worth by any definition - found that only 27 per cent held hedge funds, down from 38 per cent a year earlier. The mean investment they held in hedge funds was $1.6m.

These rich Americans overwhelmingly described their risk tolerance as "either moderate or conservative," according to Spectrem. For these people, it is not so much a question of "seeking alpha" - the holy grail of returns uncorrelated to the market - as "beating cash," or "staying ahead of inflation". This may be a form of alpha, but only the least risky alpha-generating strategies need apply.

None of this can be generalized, of course. Many entrepreneurs get rich by running one business superbly well, and then want to make sure they hold on to the wealth they created. Some, doubtless, look to carry on making huge returns, and do not mind taking the risk. But the picture of the wealthy, even including self-made entrepreneurs, as risk-averse, makes sense. They are only learning the lessons of history. Look at the Forbes list, and note how it is the entrepreneurs of today who dominate. "Old money" is there, but lower down, and falling.

One thing that does unite the top five is that they are self-made men. The same is true of much of the rest of the list. The famous names of the great 19th century "robber barons" are not to be found. Had these families' wealth merely kept up with inflation, they would have been.