

A Candid Conversation about Capital Management

David Salem
Co-Chairman

Aiming High

Ends and Means. The work done at money management firms comprises typically three main functions: (1) *Investing* (obviously!); (2) *Outreach* (i.e., interacting with existing and prospective clients); and (3) for lack of a better term, *Other* (i.e., accounting, audit, compliance, HR, IT, and myriad important additional tasks that money management firms must do well in order to succeed). While seemingly distinct, these three functions are interrelated, the most obvious nexus being the imperative for investment pros seeking to steward Other People’s Money (OPM) to persuade potential clients to become and remain actual ones. Of the various means that New Providence’s principals have employed to describe and defend their labors during their many years of collective experience investing OPM, none has proven more effective (nor enjoyable to its perpetrators if not also its end-users) than the medium employed below: a made-up conversation among fictional characters seeking to resolve important investment-related issues. More specifically, the conversation at page 3 et seq. focuses on challenges confronting many high net worth families and individuals *circa* 2013 including: (1) safeguarding portfolios’ purchasing power against the corrosive effects of fees, applicable taxes (if any), and inflation; (2) fashioning criteria conducive to the selection of money managers capable of achieving investment excellence on their clients’ behalf; and (3) crafting arrangements that align well money managers’ interests with those of clients entrusting capital to them.

Caveats. Having furnished immediately below this document’s key takeaways, we recognize that not all of the commendably busy persons to whom New Providence publications get distributed will need or indeed want to read what follows in its entirety. Whether you do so or not, please be mindful that: (1) for carefully considered reasons we’d be pleased to discuss, New Providence seeks to manage a limited amount of capital (defined below) for a select client base comprising high net worth individuals and families plus tax-exempt entities or accounts controlled by them; (2) while New Providence stewards both tax-exempt and taxable capital, the firm’s principals believe strongly that taxable wealth generally should not be commingled with tax-exempt wealth for investment purposes — a premise explored at some length in the accompanying dialogue; (3) the preceding premise notwithstanding, we believe strongly that the **principles** underlying the prudent deployment of taxable wealth differ little if at all from

those underlying the prudent deployment of tax-exempt wealth; (4) although unarguably overexposed in general as well as finance-focused media, Warren Buffett and his business partner Charlie Munger have adhered to the principles just alluded to longer and more faithfully than all other very well-known investment pros, making key aspects of their lives’ work a proper focal point for the accompanying dialogue; and (5) having argued forcefully and publicly during its ascendancy that another demonstrably successful approach to investing — the so-called Yale or endowment model — would become decreasingly effective through overuse, the following dialogue’s principal author and indeed the investment team he now heads is acutely aware that blind mimicry of Buffett’s winning ways is a probable path to mediocrity if not worse for investment pros and their clients.¹ Stating the last point differently, the cardinal prerequisite for successful investing in all market environments is to deploy capital in a disciplined manner, adhering to principles that pull capital away from strategies or tactics that are overly popular and push it toward those that are not.

Key Takeaways. The accompanying dialogue’s potentially off-putting length notwithstanding, its key point is simply stated: in the investment arena, **costs matter** — a lot more than many participants realize. This is especially true for taxable investors, because taxes (like manager fees) are levied on nominal as distinct from inflation-adjusted returns. Believing as we do that well-conceived pictures can tell thousands of words, we’ve woven several “slippage”-focused graphs into the dialogue, the most arresting of which (for us) appears below. As can be seen, if one applies to taxable wealth what we’ve dubbed a “Popular Approach” — a diversified mix of strategies and managers *qua* what many investors employ in their efforts to “be like Yale” — the resulting slippage between cup and lip is depressingly large, with just 1.3% per annum reaching this hypothetical portfolio’s ultimate owner net of fees, taxes, and inflation.

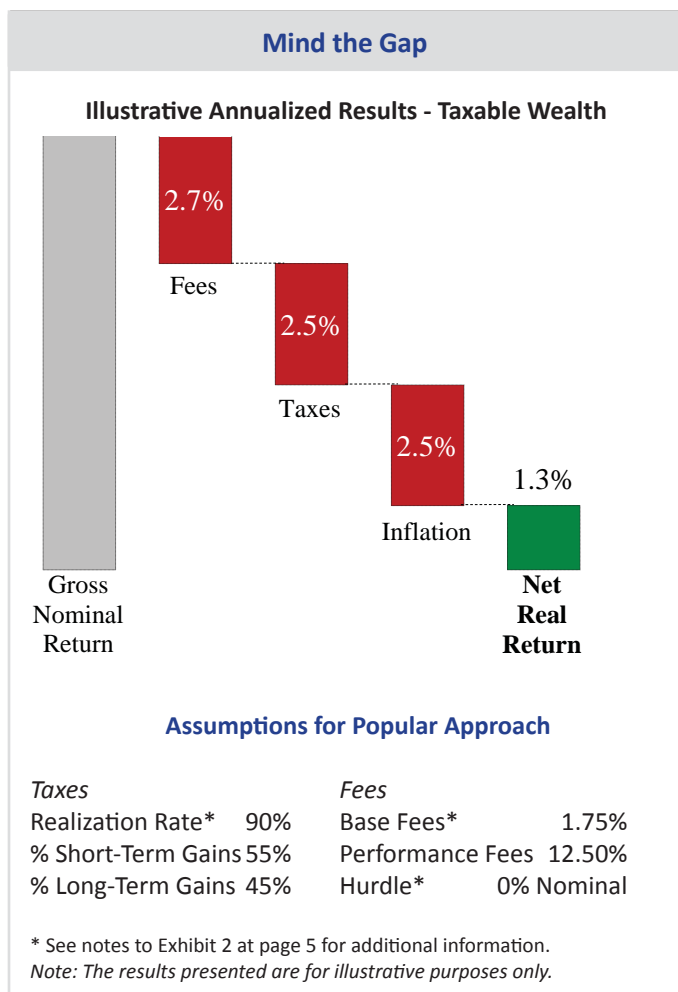
A Better Way. For **taxable** investors, the remedies are both obvious and — due primarily to commercial norms in the money management biz — hard to come

¹ The so-called Yale or endowment model of investing got turbocharged materially by the June 2000 publication of *Pioneering Portfolio Management* by Yale endowment head David Swensen. A review of this justifiably acclaimed book by New Providence Co-Chairman David Salem appeared in the June 5, 2000 edition of *Barron’s*; authorized reprints of this review are available from New Providence upon request.

by, requiring as they do (*Warning: Advertisement*) (a) unconventional portfolio designs, (b) unconventional fees and terms, and (c) uncommonly enlightened behavior by owners (a/k/a clients) as well as agents (a/k/a managers). **Tax-exempt** “owners” have a somewhat easier task, but should also pay much greater heed than most do to what Charlie Munger has dubbed artfully “the croupier’s take,” i.e., investment-related costs. Most such costs are visible and, to a large if not complete extent, controllable in advance: asset-based management fees; audit, accounting, custody, legal, and sundry other “fixed” costs or levies. Some forms of slippage are visible but generally neither controllable by clients nor determinable (in dollar terms) in advance, i.e., incentive fees and taxes. And some costs are invisible but potentially massive nonetheless, i.e., actual or opportunity costs arising from behavioral foibles committed by a portfolio’s professional manager(s) or its ultimate owner(s) — with acts of commission or omission by investment pros worried unduly about potential firings or redemptions comprising arguably the single largest cost incurred by clients as a group.

Optimal Bounds. Of course, portfolio turnover spawned by actual as distinct from potential firings or

redemptions entails real and potentially high costs in its own right, making it essential that owners or clients engaged in money manager searches ponder up-front not only their own probable behavior under worst-case conditions but that of their putative bedfellows — an imperative that’s supremely important when the revenue model (i.e., asset-based fees) plus potentially other organizational attributes (i.e., public ownership, overly egoistic founders) cause the asset base of a prospective manager to eclipse optimal bounds. Beyond a certain point — surely a much smaller figure for the vast majority of managers than for the tiny minority that are truly skilled at both managing money and structuring their own labors in a manner conducive to investment excellence (i.e., Buffett and Munger) — asset size is the enemy of superior returns. Based on the recent administration of a proprietary survey of notably accomplished investment pros conducted regularly since the early 1990s by New Providence’s Co-Chairman, the optimal asset base for “open architecture” shops like New Providence is roughly 1/12th of the \$96 billion in public investments that the “open architecture” shop known as Berkshire Hathaway controls at present, and roughly 1/30th of Berkshire’s aggregate asset base at present. Neither Buffett nor Munger nor any mere mortals know with certainty how economic conditions in general and inflation in particular will unfold over time horizons germane to New Providence’s primary investment labors, so this document contains no specific return forecasts for Berkshire shares (held both directly and indirectly by New Providence at present) or any other security or portfolio. What we can say with confidence — or more precisely can and do assert in the dialogue below — is that folks who think consensus inflation expectations are unduly low and are therefore shifting capital on the margin into perceived inflation hedges should take great care to ensure that applicable fees comport with their economic outlooks: most verifiably skilled managers absorbing fresh capital levy incentive fees tied to nominal as distinct from real returns, causing clients’ real or inflation-adjusted returns to fall (especially on an after-tax basis) as the very hazard they’ve sought to hedge against becomes more acute.



Cast of Characters. To illumine the aforementioned issues plus others, New Providence has “organized” a parley among four generally agreeable characters: (1) Marie Sklodowska, a science wiz-turned-entrepreneur who’s just sold the biotechnology firm she founded for many hundred millions of dollars in cash, post-tax; (2) Pierre Curie, Marie’s husband and father to the couple’s two young children; (3) Ulysses Grant (a/k/a “Unc”), the proverbial “Dutch uncle” who wants nothing more nor less than for his niece (Marie) and her family to navigate adeptly the perilous waters that Ulysses himself has sailed successfully during a multi-decade career as a

money manager; and (4) Alexander Hamilton, a trusted advisor whose wise counsel owes much to his careful monitoring of evolving tax laws and regulations. Our fearsome foursome has convened to discuss means of deploying prudently Marie's newly acquired wealth. As will be seen, Marie's conspicuous commercial success is attributable in part to her penchant for getting to the heart of matters with all deliberate speed.

A Candid Conversation about Capital Management

The Big Picture

Marie. Thanks, Unc and Alex, for joining Pierre and me today. You know why we're here: to decide how to deploy wisely the cash we've just pocketed. You know too that we want everything we do **or don't do** with our wealth to be guided by two principles: first, don't spoil our children; second, make our money work for us rather than the other way around.

Pierre. Us — plus the charities we choose to support.

Marie. Good point. Of course, our goal of nurturing a strong work ethic in our kids presupposes ample philanthropy by our family over time.

Alex. Quite apart from what that says about you and Pierre — good things, obviously — your plan to do lots of charitable giving boosts the potential utility for you of certain investment strategies and structures.

Marie. That's a good segue to my opening question for

Unc. Having used essentially a process of elimination to make our family fortune — testing scores of chemical compounds until I came up with one that worked — I'd like to start by having Unc flag for Pierre and me obvious means of deploying our fortune that are obviously **wrong** by his lights.

Unc. Happy to do so, Marie, after noting that your profession and mine have less in common than most folks think — even though many math and science wizzes have made fortunes for themselves managing Other People's Money.

Pierre. Are you suggesting they've gotten rich charging high fees that've left clients worse off than they'd have been otherwise?

Unc. In some cases, yes — although managers charging unjustifiably high fees tend to self-destruct eventually.

Marie. Why?

Unc. Investment pros who care more about making

money for themselves than they do about generating superior net returns for clients tend to absorb more money than they're capable of managing effectively.

Marie. You hinted at that in the checklist for vetting money managers that you put together for Pierre and me [Exhibit 1]. I'm not sure I understand all of your criteria, but I understand intuitively why excessive asset growth and fee structures that spawn it are to be avoided. My question to you is, how can Pierre and I figure out whether each of the firms clamoring to manage money for us is right-sized — and how can we figure out if its business model in general and fee structure in particular align its interests sufficiently with ours?

Unc. I won't pretend the challenges you just flagged are easy to tackle, but handling them successfully takes far less brain power than you used in making your fortune, especially if you understand the big picture.

Alex. "Big picture" as in secular trends?

Unc. Getting secular trends right is certainly a helpful condition for success in investing, although it's far from sufficient for reasons we'll want to discuss in due course. That said, the big picture to which I was alluding in this context — Marie and Pierre's search for a choiceworthy firm to manage their money — is the deceptively unstable character of money management firms.

Marie. Unstable?

Unc. Yes, typically, for reasons underlying my earlier assertion that your profession and mine have less in common than most people think, your work as a scientist being rooted in natural phenomena that humans can study but not alter fundamentally —

Marie. At the atomic level, you mean —

Unc. Yes ... whereas money management firms and the markets in which they're active are purely human constructs whose essential properties can morph over time, for good or ill, a simple example being the one already mentioned of a firm whose outreach or more precisely marketing efforts causes its asset base to grow disproportionately large in relation to its investment or back office capabilities.

Pierre. I'm no expert on managing money, or on managing people who manage money, but it strikes me that the converse phenomenon is more problematic: poor performance begets shrinking fees, which in turn beget slumping confidence and employee morale, which in turn beget even worse performance.

Exhibit 1: Suggested Money Manager Selection Criteria

Sensible Screens, Sensibly Ordered. Most frameworks for vetting money managers start and end with exclusively favorable attributes — like the famously fulsome search criteria for Yale’s president *circa* 1950 that caused one Yale votary to quip, “Is God a Yale man?” The wiser course when crafting search criteria is to employ negative as well as positive screens, in that order, negative screens typically taking far less time to administer than positive ones.

Disqualifying Attributes

- Financial arrangements that subordinate clients’ interests to the firm’s or its employees’
- Investment processes that emphasize return generation more heavily than loss avoidance
- Investment decision-makers focused unduly on tasks other than portfolio management

Undesirable Attributes

- Investment processes lacking intuitive appeal or rooted unduly in consensus decision-making
- Suboptimally large assets under management
- Suboptimally high (or low!) turnover of external managers, direct holdings, or employees

Desirable Attributes

- True “open architecture” combining value-additive internal as well as external management
- “Front office” leaders with extensive experience stewarding substantial capital
- “Back office” principals with extensive experience administering complex investment programs
- Proven willingness to decline opportunities the firm has spent many man-hours researching

Essential Attributes

- Integrity in all forms: organizational as well as individual; intellectual as well as ethical
- Well-defined investment approach providing a discernible edge in deploying capital
- Proven capacity to adapt in a timely and prudent manner to changing markets and client needs
- Robust written communications comprising real-time analyses of major portfolio moves

or more precisely marketing efforts causes its asset base to grow disproportionately large in relation to its investment or back office capabilities.

Unc. Spot on: asset-based fees generally add insult to the injuries that money management firms not uncommonly inflict on themselves and their clients, causing businesses like mine to be much less stable than they seem.

Alex. I’ve heard about money management firms dissolving when the interplay of portfolio losses and so-called high water marks causes **incentive** fees to become wildly improbable, but I’ve never viewed pure **asset-based** fees as a cause of instability in their own right.

Wobbly Stools

Unc. Truth be told, just about every aspect of life at a money management firm is a potential cause of instability, asset-based fees not excepted.

Marie. How so?

Unc. Because money management firms are like three-legged stools: stable if the legs and the load placed on them are sized properly, but inherently unstable if they’re not.

Pierre. You lost me: what legs, and what load?

Unc. The legs, if you will, in businesses like mine comprise **investing** — obviously; **outreach** or client relations; and, for lack of a better term, **other**. The load to which I’m referring is AUM — shorthand in my business for assets under management. Tying what I’ve just said back to the notion that money management firms are inherently unstable, you can see easily how asset-based fees create powerful incentives to let AUM grow above levels consistent with investment excellence —

Alex. — or back office excellence. As tax counsel to high net worth clients, I’ve seen more than a few money management firms absorb more clients if not also much more money than they’re capable of handling effectively.

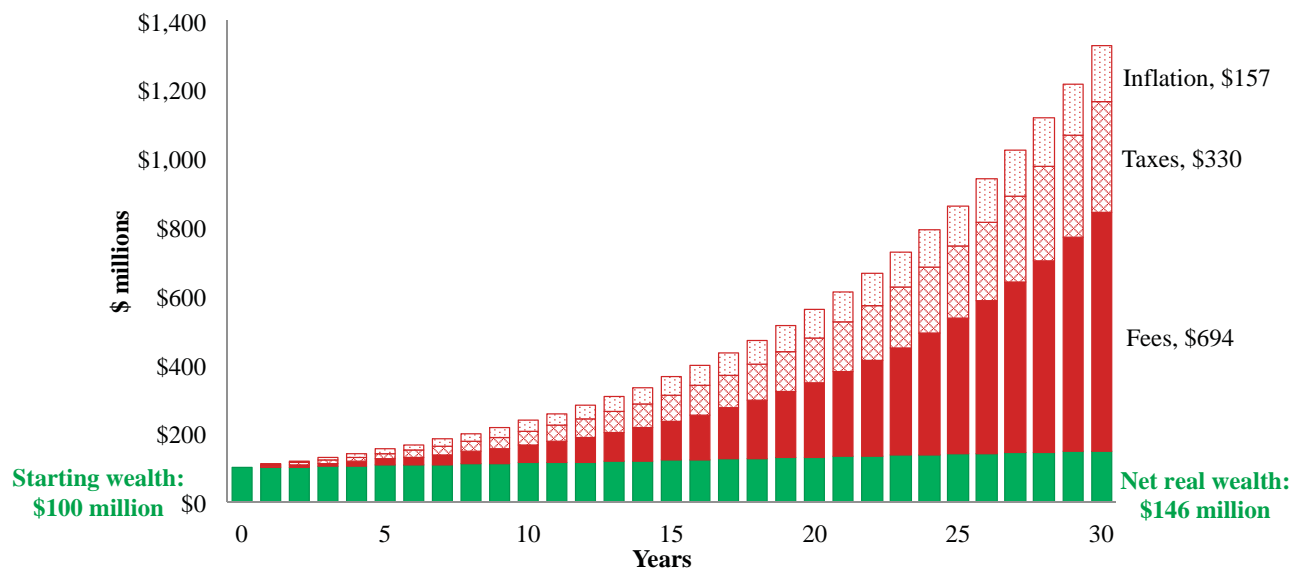
Unc. Happens all the time: the outreach or marketing leg of the stool grows bigger than the other legs, causing the whole edifice to become unstable if not tip over altogether.

Marie. You make it sound as if money management firms are as ephemeral as, say, biotech ones. Are they?

Exhibit 2: Where Are the Customers' Yachts?

Illustrative Slippage from Popular Approach

Popular Approach as Defined at Page 2



Assumptions

Annualized Returns

Passive Real Return	5.0%
Active Alpha	1.5%
Inflation	2.5%

Tax Rates

Short-Term Gain Tax Rate	43.0%
Long-Term Gain Tax Rate	26.0%

Holding Period

30 Years

Popular Approach

<i>Taxes</i>	
Realization Rate*	90.0%
% Short-Term Gains	55.0%
% Long-Term Gains	45.0%

Fees

Base Fees**	1.75%
Performance Fees	12.5%
Hurdle***	0% Nominal

* Percentage of assumed annualized total return subjected to tax each year.

** Accounting, audit, consulting, custody, fund administration, legal, and portfolio management base fees.

*** Hurdle for Popular Approach is net of base fees only, with taxes and inflation ignored.

Note: The results presented are for illustrative purposes only. Actual results will almost certainly differ, perhaps materially, from the results presented here.

Unc. You're the biotech expert, not me, so I can't comment intelligently on whether money management firms have half-lives longer on average than biotech firms. All I can say is that money management firms that survive their founders' working lives while also sustaining investment as distinct from marketing excellence tend to be tough time sustaining investment excellence due to the acute difficulties of serving simultaneously two masters with inherently conflicting interests: fee-paying clients and fee-collecting shareholders.

Marie. Funny you should mention that because the Issue you've just flagged — institutional longevity — is conspicuously absent in your preferred checklist for

implying that young Turks have an edge relative to veteran players in money management —

Pierre. — or that we should be prepared to rotate our capital among managers as each firm we choose to employ nears the end of its perceived half-life?!

Alex. Perish the thought — if not for your own sakes than for those of your children: half a glance at Unc's analysis of return slippage [Exhibit 2] tells you how suboptimal it'd be for you to move willingly down a path entailing preprogrammed portfolio turnover. Quite apart from other major sources of slippage like fees and inflation, sharing too large a fraction of your returns with the Tax Man can take a huge toll on your wealth —

Marie. Our wealth ... or our kids' ... or the welfare of charities we hope to support.

Alex. Good point, especially if you want to take a page from Warren Buffett's book on tax planning.

Pierre. Tax planning? I thought you were about to mention Buffett's "Giving Pledge" — the campaign he's undertaken with Bill and Melinda Gates to get uber-rich folks to devote more than half their wealth to charity.

Alex. They're opposite sides of the same coin — Buffett's "Giving Pledge" and his tax status, that is. I don't mean merely the complex plan Buffett's pursuing to shift most of the wealth he's accumulated into the Gates Foundation's coffers without incurring taxes. I mean too the tactic he's employed to minimize return slippage attributable to taxes since making Berkshire his primary investment vehicle five decades ago: using a "C corp" to keep the Tax Man's take to a reasonable minimum so that vastly more wealth can stay in the private sector.

Pierre. Private **nonprofit** sector, you mean, yes?

Alex. Yes — more specifically, in the Gates Foundation's coffers as well as those of Buffett family foundations, although there's no telling how much wealth generated by Buffett & Co. on behalf of Berkshire's outside shareholders will also ultimately get used by them for charitable purposes —

Unc. Or for tax-efficient bequests to heirs.

Hopes and Dreams

Alex. True: shareholders in Berkshire or indeed any other "C corp" typically can shift wealth to heirs without incurring taxes on unrealized capital gains, subject to statutory limits that are laughingly low for ultra-rich folks like Buffett, and I dare say for Marie and Pierre too, but relevant to many well-off families' hopes and dreams.

Marie. Don't assume Pierre and I have decided how much money our children should get to spend themselves, short or long-term. We called this meeting because we've come into lots of money and want to invest it wisely even as we figure out how to apply it ultimately to our own needs, our kids', and philanthropy.

Unc. Well put — and it's unwise for investors to let the tax tail wag the portfolio dog so to speak by assigning higher priority to minimizing taxes than to optimizing after-tax returns. That said, as you and Pierre ponder

what to do with the very substantial sums held in your own names at present, you'll want to focus on the costs as well as perceived benefits of popular approaches to private wealth management.

Marie. Popular? Is that a pejorative?

Unc. Not necessarily. In fact, as with the challenge to which you and Pierre have already begun devoting serious time and money — namely K-12 education — the "tried and true" often works better in my line of work than the "shiny and new," provided of course that the former isn't already overdone. Ironically, over the full sweep of my multi-decade career as an investment pro, the dominant trend by far has been the transmutation of formerly nontraditional or so-called alternative approaches into conventional or mainstream ones — a trend that's caused too much dough to flow into strategies that worked brilliantly for many well-heeled investors throughout much of the 20th century but that seem destined to disappoint in coming years and beyond.

Alex. "Disappoint" by what metric: gross ... net ... nominal ... real ... pre-tax ... post-tax? Explain, please.

Unc. Your question proves my point, Alex, which is that too many investors have shifted too much money into strategies and managers whose past success — when measured by what should matter to taxable clients like Marie and Pierre: bottom line returns net of all forms of slippage — is attributable to conditions that no longer apply. More specifically, techniques that worked brilliantly when inflation and interest rates were falling, leverage ratios and stock valuations were rising, and

Exhibit 3: Dangerous Decent

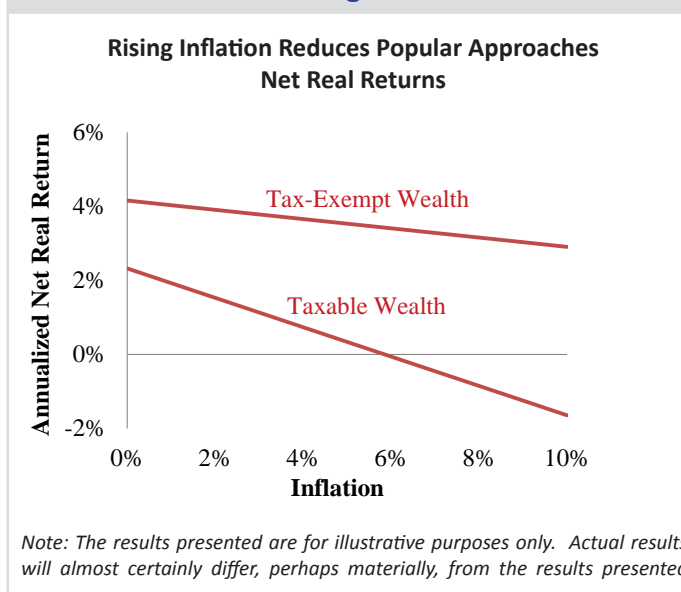


Exhibit 4: Costs Matter

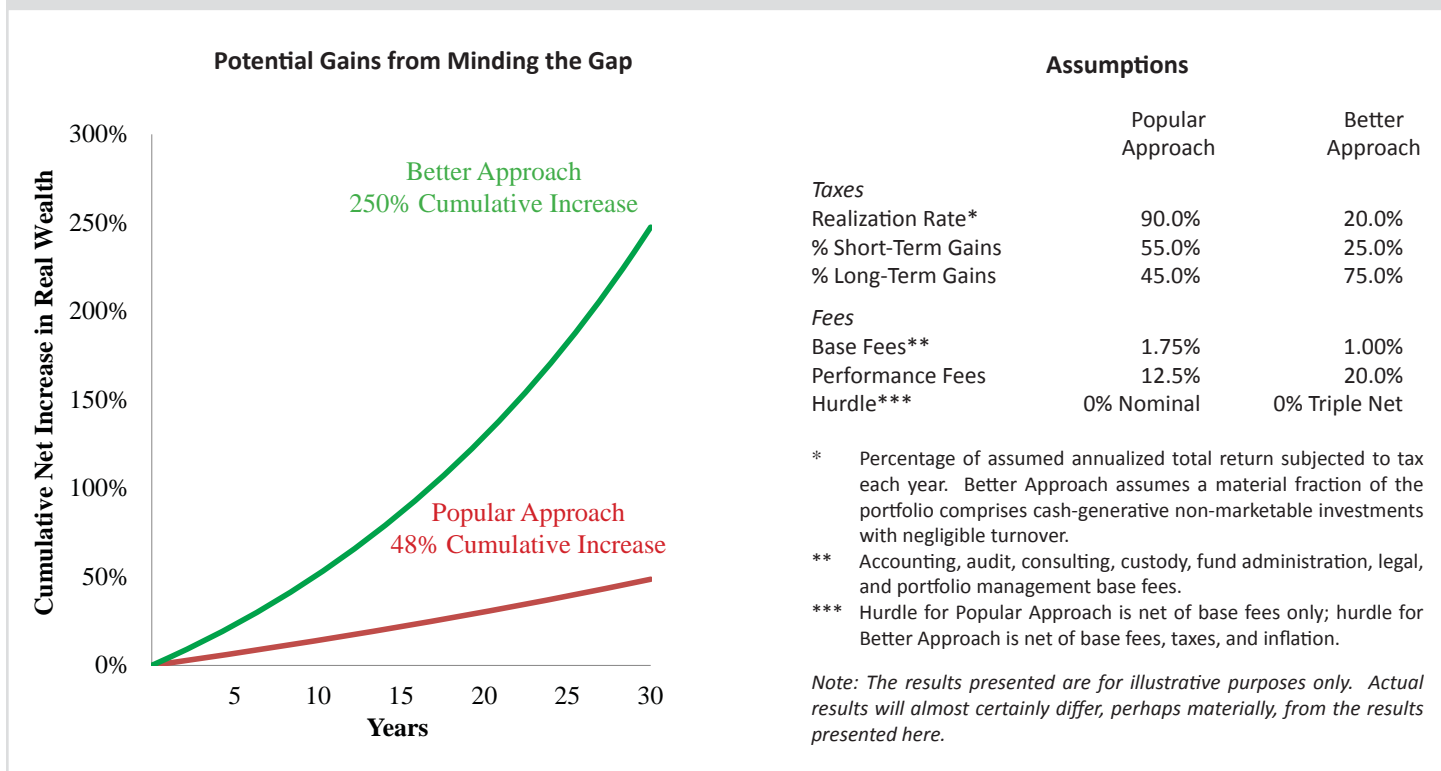
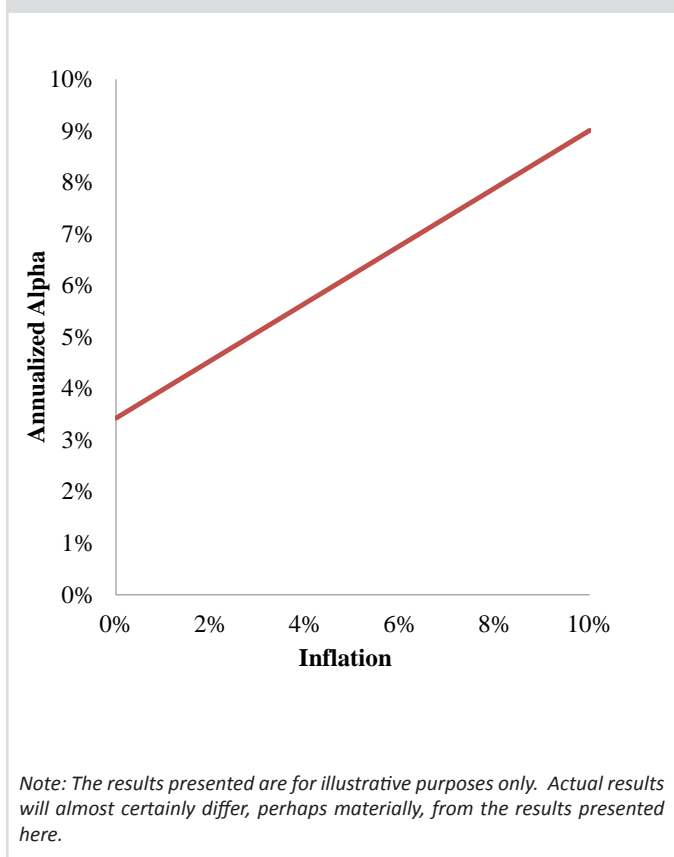


Exhibit 5: Incremental Alpha Needed for Popular Approach to Keep Pace with Better Approach



individual as well as corporate tax burdens in general were abating may work imperfectly at best over time horizons germane to Marie and Pierre. At the very least, they'll want to be supersensitive to the opportunity costs of deploying taxable capital in the same or similar manner as tax-exempt capital.

Pierre. I get that point, or rather it hit me like a two-by-four when I pondered the negatively sloping lines in the inflation study you prepared for us [Exhibit 3]. I can't believe how much return slippage some of the investment programs we're being pitched entail, especially if inflation heats up.

Marie. To be clear, neither Pierre nor I have informed views on where inflation might be headed, or — for that matter — on how the tax code might evolve.

Pierre. True. But we're all in agreement that tax rates for fortunate folks like us aren't headed lower anytime soon, and if we plug even modest inflation rates into the model that Unc used to prepare his slippage analysis, we'll almost certainly do better over the long-term — taking all forms of potential return slippage into account — by favoring what Unc calls his "Better Approach" over more popular arrangements [Exhibit 4].

Unc. Well put, Pierre. There's a non-zero probability

that you or hired guns working for you will be skillful enough deploying capital via managers charging so-called market fees to trump lower-cost alternatives, but the odds don't favor such a happy result. As you just hinted, the more inflation heats up, the tougher the challenge becomes, because you need ever-more alpha to produce ever-higher nominal returns to leave you and Marie with satisfactory real returns after the managers and tax authorities take their cuts [Exhibit 5].

Marie. Understood. What I don't understand — and this is a question for you, Unc — is why the generally well-managed nonprofits that are bombarding Pierre and me with gift appeals continue to tolerate such massive slippage between cup and lip in their own investment programs? I get the point that endowed charities don't suffer discernible return slippage due to taxes, but manager fees hit all clients paying them dollar-for-dollar — and incentive fees or carries based formulaically on realized gains are functionally identical to taxes, are they not?

Unc. They are indeed, which makes it odder still that so many perpetual life charities employ investment vehicles and strategies with built-in turnover — turnover rooted not in investment considerations but rather in the business or, more precisely, funding models that their external managers employ.

Marie. You're preaching to the choir: I wouldn't have sold my company if the VC [venture capital] funds that financed it hadn't been facing prespecified wind-up dates. More to the point, I'd like to avoid investment programs where portfolio moves are dictated by business rather than strictly investment considerations. While I'm on my soapbox, I'll add that I don't see why we should or would deploy taxable capital via investment programs geared primarily toward tax-exempt investors — not when even a truly conservative tax guru like Alex can identify so many perfectly legal ways to optimize slippage on taxable portfolios [Exhibit 6]. Nor can I see why we'd entrust capital of any kind — taxable or otherwise — to managers whose practical if not also contractually capped investment horizons are far shorter than the multi-decade span over which such wealth will be spent.

Unc. That's fine and well, Marie, although you surely recognize that the screening criteria you've just endorsed eliminate almost all of the more than 10,000 investment advisors in the U.S. alone?

Pierre. What about Buffett and Munger?

Unc. Buffett and his business partner Charlie Munger comprise perhaps the most effective investment committee ever, but they don't deploy capital as a

team for anyone other than Berkshire's shareholders, and the boundary conditions under which they've labored on Berkshire's behalf are unlike any governing other investment programs of which I'm aware.

Pierre. Boundary conditions as in lower-cost ways of putting money to work? I read the speech by Munger you assigned us for homework and thought it was spot-on, especially his endless carping about the so-called croupier's take.²

² Address by Charles T. Munger to the Foundation Financial Officers Group, October 14, 1998, posted with Mr. Munger's permission on the website of the TIFF Foundation (TF). New Providence Co-Chairman David Salem is TF's founding president, serving in this capacity on a *pro bono* basis since leaving his post as TIFF's chief investment officer in late 2010.

Exhibit 6: Optimizing After-Tax Returns

Tools of the Trade. As is generally true of well-framed criteria for vetting money managers, means of deploying taxable wealth in a sensible manner are usefully subdivided into rank-ordered groups, with the top-ranked group comprising essential "tools of the trade," the second comprising useful but not strictly essential techniques, and so on.

Essential Tools

- Client-specific performance reports reflecting as many "nets" as possible*
- Comprehensive coordination of portfolio activity to avoid material tax-related no-no's**
- Forward-looking thought process***

Important Tools

- Ongoing tax loss harvesting — and its kissin' cousin, "gain management"
- Tax lot management, i.e., FIFO (highest-in, first-out) instead of FIFO (first-in, first-out)
- Deferral of gains pending achievement of holding period thresholds for long-term tax treatment

Other Potentially Useful Tools

- Purchase or sale of derivatives to control concentrated positions' risks in a tax-efficient manner
- Tilting away from (or toward) relatively high (or low) yielding securities
- Timing entries/exits respecting open-end commingled funds to optimize after-tax results

* "Nets" as used here means net of fees, inflation, and applicable taxes (actual or estimated).

** Such taboos in this context include myriad ill-timed trades including but by no means limited to wash sales.

*** Anticipating future tax law changes; shifting "coiled springs" and/or low basis assets into younger generations' hands; deferring realization of gains pending charitable transfers and/or step-ups at death.

Alex. I too read and liked Munger's speech about the croupier's take, even though he was addressing an audience of foundation types and hence ignored the many clever steps that he and Buffett have taken to optimize after-tax returns.

Bumpy Road

Marie. I may know just enough about investing to be dangerous, but I know enough about Buffett to admire both how he's made his money and what he's decided to do with it and have no qualms about mimicking steps he's taken to do well and good at the same time.

Unc. Perhaps, but before you and Pierre head down the yellow brick road of wealth creation that Buffett's traveled you need to understand how difficult it is to traverse.

Pierre. Difficult? From what I know about Buffett, what he's done to become fabulously wealthy is pretty straightforward: borrow mounds of money to buy some or all of the shares of a small number of unsexy companies; hold 'em forever; and keep overhead broadly defined to the bare minimum.

Marie. Does Pierre have that right? Has Buffett really made his fortune doing leveraged buyouts?

Unc. Yes and no. Yes, in the sense that he's used cash generated by Berkshire's insurance units to fund investments in other businesses, private as well as public — a form of leverage or borrowing that's been both cheaper and more stable for Berkshire than debt employed by buyout specialists as a group. No, in the sense that only a trivial part of the wealth Buffett has accumulated since he took control of Berkshire derives from money management fees *per se*. In other words, unlike the private fortunes of many of the mega-wealthy people who've signed Buffett's Giving Pledge, an immaterial fraction of Buffett's wealth is attributable to fees earned managing Other People's Money.

Alex. Indeed — although tax geeks like me admire the way Buffett has enabled Berkshire's outside shareholders to in essence deduct the costs of having their capital stewarded professionally.

Marie. Are you implying that fees Unc's clients have paid him over the years haven't been fully deductible by them?

Alex. Probably not, except for any carries he's earned — you know, the "20" in so-called "1 and 20" fee constructs that remain the norm for many world-beating money managers.

Marie. The carries are essentially deductible because they come off the top, so to speak, with taxable returns reduced accordingly?

Alex. Correct, although, as your uncle admits freely, the returns trumpeted by some of the most coveted private investment managers can be vastly higher than the returns actually pocketed by their clients — even if the clients are tax-exempt.

Pierre. Why's that?

Unc. Because the IRRs [internal rates of return] that some pros in my line of work trumpet are based in part on valuations of shares distributed in-kind to clients — valuations that can differ hugely from the prices at which such shares ultimately get sold, if ever. Yet another dirty little secret about money management broadly defined.

Marie. Forgive me for sounding like one of those Buffett groupies who make a pilgrimage to Omaha every spring to hear Buffett and Munger preach in person, but why wouldn't we simply skirt the minefield of suspect practices you're helping us navigate by investing the bulk of our fortune in Berkshire itself? Buffett may not live forever, but the business culture he's created at Berkshire could, and he's surely taking steps to fill or at least downsize his own shoes in anticipation of his eventual demise.

Unc. He is indeed, as manifest most conspicuously in Buffett's relatively recent and surprisingly unheralded shift toward a so-called open architecture approach to money management — a business construct whereby capital allocators put money to work both **directly**, as Buffett has done for decades via both publicly traded and private equities, and **indirectly** by funding sub-portfolios managed by outsiders or pseudo-employees.

Marie. Pseudo-employees?

Unc. That's my own term for the role now being played at Berkshire by two stock-pickers [Todd Combs and Ted Weschler] who are much younger than Buffett but have nonetheless earned his trust and, with it, multi-billion dollar money management mandates from the master himself. Both now manage money more or less exclusively for Berkshire, from locations far removed from Berkshire's headquarters and with the same broad discretion respecting buys and sells that you'll want to give to the wealth manager you ultimately pick — or, by extension, to any subadvisors your wealth manager employs under an open architecture construct. Speaking of which, Buffett's participation in the recent buyout of Heinz can be fairly described as a further move toward an open architecture approach to investing, the buyout

itself having been spearheaded by a Brazil-based private equity firm founded and controlled by another capital allocator and philanthropist *par excellence*, Jorge Paulo Lemann.

Alex. It's hard to argue with Buffett's record as an effective allocator of capital, even if a Type A guy like me finds it puzzling that he and Munger could partner so successfully from geographic bases as distant from each other as Nebraska and California — and even if tax geeks like me rail against the unnecessary layer of taxes to which this dynamic duo's clients, or more precisely Berkshire's shareholders, have been subjected.

Pierre. Unnecessary because truly skilled money managers typically ply their trade through flow-through entities rather than taxable corporations like Berkshire?

Unc. That's indeed what Alex means, although superior analytics aren't the sole or even primary reason that Buffett has compounded capital so effectively; ironically, the chief reason he's done so well is that he got structured for success at the outset — by making a taxable corporation his investment engine of choice, incurring entity-level taxes to be sure but also ensuring that the clients to whom Alex alluded a minute ago couldn't jump ship at inopportune times — or indeed ever.

Marie. Assuming the "clients" to whom you're referring are synonymous with Berkshire's shareholders, I get your point: the only way they could essentially fire Buffett would be to sell their shares. Why would anyone who didn't need ready cash for spending purposes ever do such a thing, especially if their Berkshire position entails unrealized gains that'll get taxed if they do indeed jump ship?

Unc. Great question — one that takes us to the heart of the challenge you and Pierre are facing as you seek to do well if not also good with your newly acquired fortune. You'll recall that I said earlier that money management firms are like three-legged stools —

Pierre. — inherently unstable ones, at that, with inevitable imbalances in the three functions that money management comprises — investing, outreach, and other — putting investment advisory firms like yours, Unc, in a near-constant state of disequilibrium.

Unc. Exactly. Forgive me for injecting a second and hence potentially confusing trinity into this discussion, but the investment process itself comprises three elements, all of which Buffett has gotten legendarily right and at least two of which most investors, pros as well as amateurs, get woefully wrong. Care to guess

what they are?

Marie. Let's see ... there's an **analytical** element, for sure ... and a **structural** one: fees, terms, redemption rights, that kind of thing ... but I'm unsure about the third.

Unc. Look in the mirror, or rather look at the countless human beings who buy and sell shares every minute of every business day —

Pierre. — or who program computers which do just that.

Unc. Don't think for a second that program trading has changed materially or even discernibly the third and by far most important element of investing — amateur or professional, past or present, public or private — namely, the **behavioral** element.

Marie. I see where you're headed: Buffett may be a great analyst, and there's surely genius in his choice to apply his investment labors to permanent capital only, but his true genius lies in his capacity to **behave** wisely — to be fearful when others are overly greedy and greedy when others are overly fearful.

Unc. That was indeed the point I was seeking to drive home, though it's important to note that Buffett's **behavioral** edge is rooted in superior **structuring** — superior, that is, if but only if folks delegating capital allocation decisions to Buffett are well behaved themselves. Many proved otherwise when their and indeed Buffett's patience was tested to the max in the late 1990s, long before recent advances in computer-based trading reduced the average holding period for public companies' shares to laughable levels.

Marie. I sense an object lesson approaching.

Unc. The lesson is this: even though you and Pierre can't choose the macroeconomic conditions under which your fortune gets deployed by whichever wealth manager you select, you **can** choose the boundary conditions governing your manager's labors. The most important such condition by far is optionality—the right to withdraw some or all of your capital. Like all rights, the right to redeem from a manager or fund entails costs. Some are explicit and hence knowable in advance: prespecified redemption fees on commingled funds, for example. Most are both hidden and unknowable in advance: opportunity costs that clients incur by demanding withdrawal rights that in turn cause managers to fret unduly about business as distinct from investment considerations; and real costs that principals like you and Pierre incur by abandoning agents or managers at inopportune times. A classic

example is Berkshire *circa* 1999, a year in which Buffett's preferred metric for assessing his prowess as capital allocator-in-chief — Berkshire's book value per share — lagged the S&P 500's total return by more than 20% (0% vs. 21%). Thinking the "old man" [Buffett, then age 69] didn't and couldn't appreciate the wonders of the "New Economy," folks who'd formerly trusted Buffett to allocate capital on their behalves removed such trust, dumping Berkshire shares so aggressively that the firm's price-to-book value per share fell 20%.

Pierre. Wait: if Berkshire's book value per share was essentially unchanged on the year [1999], and its price-to-book value fell 20%, then shareholders suffered a 20% loss — a shocking 41% less than they'd have earned investing in an index fund tracking the S&P 500 in 1999. That's more than 20 times the two percent (2%) annualized net spread over the broad equity market that you, Unc, said we can reasonably expect to earn long term — pre-tax! — if we're lucky enough to pick a top quartile-performing, long-only stock manager, and it's more than eight times the annualized excess return or alpha you said we'd be fortunate to capture if we're brave enough to shift most of our investable wealth into private as distinct from public companies. I understand now why you argued earlier that the yellow brick road Buffett & Co. has traveled ain't been easy to traverse.

Marie. But it has led to immense riches — and if I'm not mistaken, it didn't take long for clients or rather shareholders of Buffett & Co. who stayed the course during the late 1990s to recapture lost ground and more. Didn't Berkshire shareholders fare even better when the Tech Bubble imploded, relatively speaking, than they'd fared poorly as it was inflating?

Unc. They did indeed, Marie, and I'm pleased to know you've heeded my advice to spend as much time as possible studying financial history. As you and Pierre know, in addition to a somewhat subjective checklist of sorts for picking a wealth management firm [Exhibit 1], I've given you an even more subjective checklist of sorts for the behavioral traits or more precisely aspirations you'd ideally see displayed in the investment pros actually stewarding your wealth [Exhibit 7]. You may be unable to determine if any such individual is truly expert in, say, the tax tactics we discussed earlier [Exhibit 6], but you could and should verify that investment pros handling your dough are steeped in financial history, including but not limited to what transpired in the late 1990s and early 2000s. In fact, as against a cumulative total return of -40% for the S&P 500 during the three years ending December 31, 2002, Berkshire shareholders notched a cumulative total return of 30% — zero from dividends, because Berkshire pays none and perhaps never will, and hence

30% from share price appreciation, reflecting 10% growth in Berkshire's book value per share and a 20% rebound in its price- to-book value ratio.

Alex. Those figures tell me that Buffett stayed the course with his so-called Old Economy stocks, something that other proven investment pros like Julian Robertson and George Soros couldn't do at the time due in large part to structural choices they made when setting up their own investment shops years earlier. I did tax work

Exhibit 7: Axiomatically True

Deceptively Difficult. Investing effectively is simpler than most people think — and than most investment pros willingly admit — but very difficult too, for behavioral as distinct from analytical reasons. Herewith a partial list of investment-related axioms — none truly actionable but arguably useful if only as constant reminders — underpinning many conspicuously successful investment programs.

- By the time investors accumulate sufficient evidence suggesting that an asset class or strategy produces superior returns, the big bucks have already been made.
- All the information is there—you just have to quiet the mind to hear it.
- Lacking the skills and/or discipline to distinguish truly important information from other stimuli, most investors feel compelled to act when inaction would be the wiser course.
- Look for anomalies: what's happening that shouldn't and what isn't happening that should?
- Almost no one is a true contrarian. Strive to be one, whenever possible.
- "Only the paranoid survive." Be eternally vigilant, never complacent.
- Be more humble, the more the market goes your way.
- Learn from the mistakes of others — and your own.
- Be disciplined but flexible. Every rule is made to be broken.
- The last great investment trauma shapes profoundly subsequent investor and business behavior.
- Study history, especially financial history.
- If you can't get the secular trends right — a task whose difficulty is eclipsed only by its importance — entrust capital to folks who can and do, favoring especially corporate managements able to not merely call secular trends but create them.

Note: Adapted in part from *What I Learned This Week*, 6/20/2013 edition, ©13D Research (www.13d.com). New Providence is a grateful subscriber to this well-written and always thought-provoking publication.

for folks who got caught up in the vortex of big hedge fund unwinds around the time Buffett's relative returns were bottoming, and I remember thinking at the time how much better off such folks would've been if they'd paid closer attention to fund structures and the probable behavior of their putative bedfellows or co-investors under worst case conditions

Sensible Shortcuts

Marie. Hold on: the logical corollary to what you've just said is that highly disciplined approaches to equity investing of the sort Unc has commended to our attention [Exhibit 8] are for naught if other factors conducive to long-term investment success aren't present in sufficient measure, including well-behaved bedfellows. Goodness gracious: picking the

right firm to manage our money is starting to sound more complex than the lab work that enabled me to make so much money in the first place. Aren't there some sensible shortcuts we can take to separate the wheat from the chaff, Unc — especially when it comes to vetting prospective managers' **other** clients?

Unc. I'll keep my answer brief because I'm hoping to seal within the next few hours a deal on which I've been working for the better part of three days.

Pierre. Three days from start to finish? Can't be a very big deal.

Unc. Actually, it is, dollar-wise, but I've been buying equity stakes in companies other than my own, private as well as public, long enough to reach yea

Exhibit 8: Suggested Equity Investment Criteria

Separating Wheat from Chaff. Given the large number of equities available for purchase by investment pros pursuing a truly opportunistic approach to investing — fully globalized, private as well as public — it's essential that such pros use wisely the scarcest resource available to them or indeed any mortal being: time. Three corollaries follow: (1) equity investment processes must be sensibly ordered, with screens applied in a manner likely to separate wheat from chaff in the most time-efficient manner possible; (2) negative as well as positive screens should be employed; and (3) 'tis logical to apply even highly time-intensive screens earlier rather than later in the process if doing so saves time overall. This helps explain why certain concededly time-intensive screens (e.g., those focusing on corporate culture) appear earlier rather than later in the framework below.

Step 1 — Eliminate Companies Displaying **Disqualifying** Attributes

- substantial insider selling of shares being considered for purchase
- high degree of unplanned turnover at the board or upper management levels
- flawed corporate culture as manifest in major product or accounting missteps or heavy reliance on public relations

Step 2 — Eliminate Companies Displaying Too Many **Undesirable** Attributes

- relatively high reliance on commodities-based sales
- relatively high reliance on sales to unstable or financially troubled governments
- steadily declining or suspiciously rising profit margins
- excessive leverage in relation to the inherent volatility of core businesses under worst case conditions

Step 3 — Eliminate Companies Displaying Too Few **Desirable** Attributes

- business lines with low vulnerability to technological or regulatory changes
- products or services with proven appeal to sizeable and inherently addressable markets
- proven business models entailing relatively low external financing requirements as sales grow
- pricing strategies capable of sustaining satisfactory profit margins across a broad array of economic scenarios
- products or services whose essential design, features, and value proposition are readily understood by outsiders
- well-timed reductions in outstanding shares via serial repurchases financed by operating cash flows

Step 4 — Eliminate Companies Displaying Too Few **Important** Attributes

- a high degree of inside ownership, manifest ideally as *de facto* control by founders and their families
- employee compensation norms that incentivize shareholder-oriented behavior
- clear, candid, and humble oral and written communications from top management

Step 5 — Eliminate Companies Failing to Display An **Essential** Attribute

- shares available for purchase at a **price** consistent with achievement of applicable long-term return goals

or nay decisions pretty quickly — perhaps not as swiftly as the Oracle of Omaha, who has made vastly bigger purchase decisions on occasion, but quickly nonetheless.³ Come to think of it, as you and Marie continue trying to separate wheat from chaff in the wealth management arena, you might find helpful a shortcut I use routinely in vetting companies in which to invest: focus on the clarity and candor of senior management's communications, oral as well as written.

Marie. With all due respect, Unc, that doesn't sound particularly distinctive or productive to me.

Unc. You'd be surprised, especially if you focus as much attention on what prospective managers **don't** say as on what they **do** say. More specifically, you want to give the boot immediately to managers who talk about future returns and means they'll employ in their pursuit **before** discussing risks. Not risks in the abstract, mind you, but the forms and degrees of risk that you and your family in particular are able and willing to incur.

Getting Rigorous about Risk

Marie. I don't want to mess up your deal-making schedule but I'd like to hear at least a tad more about risk. I've been assuming that the only form of risk that truly matters to my family is the risk of permanent impairment of capital.

Unc. Marie, my dear, if you can move through life worrying exclusively about that form of risk — absolute as distinct from relative return risk — you'll have a huge edge as an investor or, more to the point here, as the client of conscientious investment pros. For what it's worth, I look for precisely that mindset when vetting managements of companies in which to invest. As you already know or will hopefully learn well and soon, financial history is replete with sad tales of companies that foundered because their leaders placed undue importance on relative measures rather than absolute ones — Chuck Prince at Citigroup circa the mid-2000s, for example. Given the benefits we've already discussed of keeping portfolio turnover to a prudent minimum within taxable accounts, it follows that managements of companies in which you hope and expect to invest over the very long term will define financial success the way you yourself define it: compounding capital over time, net of every form of slippage to which investable wealth is vulnerable, including but not limited to fees and taxes.

Marie. Agreed on all counts. Why, then, does the refreshingly brief set of investment guidelines you urged Pierre and me to plagiarize [Exhibit 9] reference **relative** returns?

Unc. Because I've been managing Other People's Money for roughly the same number of years that you and Pierre have been alive, and I can count on one hand the number of clients who are truly indifferent to relative returns. The two of you may be exceptions that prove the rule, but unless you're certain you can endure underperformance of the sort that Berkshire's shareholders experienced in the late 1990s, 'tis best to guard against the possibility of getting whipsawed by defining up front how much underperformance is too much.

Pierre. One more question before you run, Unc: why don't the policy guidelines you gave us include the obligatory target weights and ranges for various asset classes in which we might invest? I've spent some time recently researching best practices for family foundations and many that seem to be well managed

Exhibit 9: Illustrative Investment Policy Statement

Risk Parameters. The multi-generation trusts covered by this mandate will be deployed in a manner that seeks to avoid (1) 35% or greater peak-to-trough declines in inflation-adjusted unit values or (2) annualized shortfalls exceeding 3%, relative to the MSCI All Country World Index, over rolling 10-year periods.

Return Objective. The trusts will be managed to maximize annualized real returns net of all costs and taxes over rolling 10-year periods while adhering to the risk parameters set forth above.

Liquidity Constraints. A minimum of 10% of the trusts' net assets shall be invested in holdings (including externally managed commingled funds) readily reducible to cash within 12 months; and a minimum of 20% of such assets shall be invested in holdings as just defined readily reducible to cash within 60 months.

Oversight Committee Composition and Duties. The family's designated Investment Committee (IC) is responsible for overseeing the trusts' deployment. The IC shall comprise at all times not fewer than three nor more than five members, and shall meet as needed though not less than twice each calendar year. A majority of the IC's members shall constitute a quorum for all applicable legal purposes. The IC's duties are to: (1) establish and approve appropriate investment policies and guidelines for deployment of the trusts' capital; (2) review regularly implementation of such policies and guidelines; and (3) in cooperation with the trusts' designated external auditor, select and monitor the trusts' external custodian.

³ Warren Buffett's investment approach and those of seven other notably effective capital allocators are described with admirable concision in *The Outsiders* by William N. Thorndike, Jr. (Harvard Business Review Press, 2012).

have such frameworks in place. Of course, they also typically have investment consultants in place, and I suppose the consultants deserve credit — or perhaps it should be blame — for injecting such disciplines into the mix?

Unc. I don't have a big problem with such frameworks for endowed charities, especially publicly supported ones that must continually attract fresh capital from donors whose risk metrics might not be as absolutely enlightened, pun intended, as yours and Marie's. That said, computer-based asset allocation models of the sort to which you're alluding tend to work best when they're used for descriptive rather than prescriptive purposes. More to the point, none of the legendarily successful private investors of whom I'm aware have used such frameworks to make, or maintain, their personal fortunes.

Marie. You mean Buffett and Munger don't use a computer-based asset allocation model to determine where in the world to invest Berkshire's billions?

Unc. Not a chance. They've been allocating capital effectively and indeed massively for almost as long as the company whose shares have turbocharged Berkshire's performance in recent years has been making computers — all without using IBM's machines or any other manufacturer's to make such decisions. Of course, given the absolute size of Berkshire's investable wealth — almost \$100 billion in public equity investments at present and more than twice that much dough when Berkshire's aggregate investment firepower is considered — even a newbie quant jock at a big pension fund that relies heavily on computer-based models would think twice when "modeling" Berkshire's so-called efficient portfolio: return assumptions that seem plausible for, say, a \$1 billion or even \$10 billion institution become wildly implausible for much larger pots of dough, especially if the hypothetical portfolios' efficiency rests on the assumed use of strategies that are inherently size-constrained, like venture capital. You get the point, I'm sure.

Pierre. I do, but I didn't appreciate until now the great irony in Buffett's reputation having reached a fresh zenith due in part to his investment in a firm whose seeming complexity made it forbidden fruit in Buffett's own eyes when IBM and other tech stocks were soaring in the late 1990s. What an amazing turnaround tale — for Buffett as an investor no less than for IBM.

Strongly Held Views

Unc. I really must go, but before I do ... a few more

thoughts for you to consider.

Marie. A few as in three? We love you Unc, and — not but — your best ideas almost always involve threes, like the argument you made earlier that money management firms are like stools whose three legs — investing, outreach, and other — are tough to keep right-sized.

Pierre. — or the idea that successful money management entails effective handling of three interrelated challenges: analytical, behavioral, and structural.

Unc. I'm flattered you've paid such close attention to me and hope you won't mind my introducing another trinity into the mix.

Marie. The one about investment styles?

Unc. Exactly. To avoid confusion, I thought it might be helpful to put my favorite trinities, so to speak, on a single page, like this [Exhibit 10].

Pierre. I like it, Unc, especially you're parsing of what seems like an impossibly broad universe of investment approaches into just three generic styles. That's a terrific tool for pushing managers to tell us precisely what their investment edge is — if indeed they have one.

Unc. Some do, some don't. Obviously, I think you should favor so-called long horizon wealth-creating strategies, especially for whatever wealth remains in your own names and hence subject to taxation. That brings me to the second of my three concluding points, which is both a parting shot at asset allocation frameworks of the sort we discussed a few minutes ago — frameworks whose insensitivity to current valuations makes them suspect at best — and a shout-out for a different sort of framework, like the one I've sketched on the whiteboard [Exhibit 11]. This kind of framework can be useful, if only to remind you of the multiple generic means to effective deployment of large private fortunes. If I were in your shoes, I'd look for a money management firm that could put most if not all of these means to effective use on your behalf, so that you can delegate to qualified pros the ongoing duty of deploying in a truly holistic or coordinated manner all of the investable wealth that you control, whether already shifted into charitable entities or not.

Marie: Be honest, Unc. Are there actually money managers available to us who pass the test you just outlined while also fulfilling tolerably well the other selection criteria we discussed earlier [see Exhibit 1]?

Unc. Truthfully, there aren't many.

Exhibit 10: Tropical Trinities - Fiduciary Friendly Frameworks for Vetting Money Managers

Investment Styles*

Choiceworthy money management firms have an edge in **one** of three mutually exclusive forms of investing:

Liability-Hedging: achieving payment certainty

Short Horizon Active Management: generating capital gains via adversarial short horizon trading

Long Horizon Wealth Creation: acquiring cash-generative assets at a reasonable price

* Adapted from *The Ambachtsheer Letter*, KPA Advisory Services Ltd., www.kpa-advisory.com.

Essential Functions

Choiceworthy money management firms achieve ongoing balance among three essential functions:

Investing

Outreach: interacting with existing and prospective clients

Other: myriad additional tasks including accounting, audit, compliance, HR, IT, etc.)

Cardinal Challenges

Choiceworthy money management firms tackle effectively three cardinal challenges:

Analytical: vetting wisely investment opportunities and perils

Structural: optimizing fees and terms governing services rendered to clients

Behavioral: minimizing foibles rooted in human nature

Endless Tasks

Choiceworthy money management firms handle astutely all three aspects of the portfolio management craft:

Selecting: determining what to buy or sell

Timing: determining when to buy or sell

Sizing: determining how much to buy or sell

Pierre. But there are lots of managers who claim to fit the bill, and not a few who claim that they'll change their business models if not also staffing to meet our needs.

Unc. That brings me to the third and final point I wanted to make in wrapping up this conversation. It's a point — actually, a principle — that your hero Warren Buffett or rather his long-time partner Charlie Munger has promulgated forcefully and repeatedly over the years: don't invest in turnarounds — and, by implication, don't entrust capital to firms whose essential DNA is incompatible with their evolving strategic plans and priorities.

Pierre. Haven't some people made really big bucks doing turnarounds?

Unc. For sure, especially if they've used other people's money — equity or even better debt — to finance them.

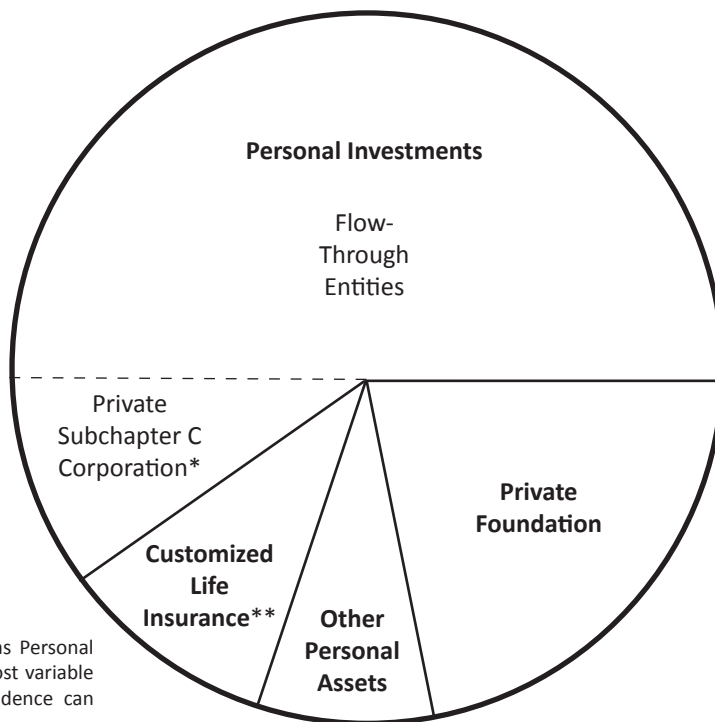
But investing is a game of probabilities, not certainties, and as Munger has argued *ad nauseam*, organizational cultures, once they take root, are virtually impossible to change for the better ... materially and sustainably.

Marie. Like individual humans, I suppose: long before parents are able and willing to cease molding their offspring in desired ways, the wee cakes are already baked!

Alex. That's a clever way of making an important point — one that'd comprise the entirety of any checklist for choosing money managers or indeed portfolio company managements I'd put forward if you asked

Exhibit 11: Illustrative Deployment of a Large Private Fortune

“Slice” sizes below demonstrate suggested apportionment of a hypothetical family fortune.



* Holdings resemble those held as Personal Investments but with heavier emphasis on tax-favored dividend income; New Providence can elaborate upon

** Holdings resemble those held as Personal Investments, “wrapped” in a low-cost variable life insurance contract; New Providence can elaborate upon request.

	Purpose <i>To preserve and enhance purchasing power of ...</i>	Targeted Holdings	Targeted Current Yield	Targeted Turnover	Tax Treatment
Personal Investments					
<i>Flow-Through Entities</i>	Taxable capital	Equity-dominated (private and public) but opportunistic	By-product of total return focus	Very low	Flow-through entity(ies)
<i>Private Subchapter C Corporation</i>	Taxable capital destined for charitable or testamentary gifts	Equity-dominated (private and public) but opportunistic	By-product of total return focus	Very low	Taxable entity subject to standard “C Corp” treatment
Customized Life Insurance	Taxable capital destined for post mortem transfer(s)	Equity-dominated (private and public) but opportunistic	By-product of total return focus	By-product of total return focus	Generally exempt from current income and gift and estate taxes
Other Personal Assets	For current (<i>inter vivos</i>) use	Residential realty, other personal use assets	Assumedly negative due to depreciation, insurance costs, etc.	By-product of current use patterns	Generally exempt from income taxation but subject to other taxes
Private Foundation	Tax-exempt capital	Endowment-like multi-asset portfolio	By-product of total return focus	By-product of total return focus	Tax-exempt excepting UBTI levies

me for something especially short and sweet.

Marie. What's your point?

Alex. According to a Stanford Business School study done some years ago, the single most reliable indicator of business success among the school's alums was whether they earned money on an arm's-length basis before the age of 12.

Marie. Reason enough to maintain our hard copy subscriptions to newspapers, Pierre — so our kids will have the chance to work paper routes —

Unc. — and do well and good at the same time. Besides, with Buffett scooping up newspapers left and right, chances are increasingly good that any subscription dollars your kids help collect will get converted ultimately by Buffett into Gates Foundation grants —

Alex. — without Uncle Sam snagging a discernible fraction of such dough in the process.

Marie. On that happy note, gentlemen, we stand adjourned.

End