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Comparing high-net-worth and institutional investors

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Consider +3.39 percent versus -1.26 percent.

These percentages represent the annual returns of the average institutional investor and the average high-net-worth investor, respectively, in the 10 years ended Dec. 31, 2008.

Some may argue this is an apples-and-oranges comparison, because the objectives of high-net-worth investors are different than most institutions.

After all, high-net-worth investors' nonretirement plan assets are subject to taxes; their time frames are shorter and theoretically more conservative. They may need more income from investments, and they have smaller asset bases.

While all of these items are true, our studies indicate that institutions outperform on a risk-adjusted basis, in good markets and bad, in short-term periods and for the longer term.

We believe there are several clear differences in approaches between these two types of investors, and high-net-worth investors would improve their investment performance if they followed the way of most institutions.

Institutions typically have very clear goals and objectives.

Portfolios for foundations and endowments are designed to meet spending policies, and defined benefit retirement plans to meet actuarial assumptions. The downside risk of their portfolios is often quantified.

As a result, when markets struggle, institutional investment committees are more grounded in their investment decisions. Goals are usually outlined in an investment policy statement, which spells out specific objectives, the rationale for asset allocation, and the process for selecting and monitoring investment products and managers.

Institutions are typically process-oriented.

Institutional investors are fiduciaries, managing money and assets for others. Fiduciary responsibility hinges on process, not performance. Focusing on process creates an atmosphere of rationality where investment decisions are made with more research and contemplation, and less emotion.

Process also helps to focus the in-vest-or on objective portfolio design. Consequent-ly, the portfolio is less susceptible to the Monday-morning quarterback who makes decisions in a rear-view mirror, often hurting performance.

Institutions are usually more diversified.

Asset allocation drives performance. Institutional investors usually take a more thoughtful approach to designing a portfolio to meet the specific goals and objectives of the investment fund. Alternative investments (hedge funds, real estate, commodities and private equity), which many high-net investors can't or don't access, can drive better risk-adjusted performance.

Institutions use sophisticated benchmarking and monitoring techniques.

Institutions typically design custom benchmarks designed to help their committees understand the underlying components of a portfolio. The goal is to understand why the portfolio performed the way it did.

Performance attribution breaks apart the components of each manager's return and helps to separate luck from skill, allowing for better decision making when evaluating specific managers.

In addition, institutional investors tend to focus more on the qualitative aspects of money-management firms and products. As a result, committees tend to make portfolio changes that are more forward-looking, as opposed to reactive to past performance.

Institutions usually use better advisers.

Most institutions utilize fee-only advisers with deep teams that have a research focus. Brokers with conflicts of interest are utilized much less often in the institutional marketplace. Institutional advisers typically act as an extension of an investment committee or board of trustees, without the motivation to make commissions or sell proprietary products.

High-net-worth investors can learn valuable lessons from the institutional investor. While no investment portfolio is immune from portfolio losses, the key to better returns is using a thoughtful and rational approach, focusing on specific personal objectives, and utilizing advisers that add value from objective advice. As our study indicates, positive investment results will follow.

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