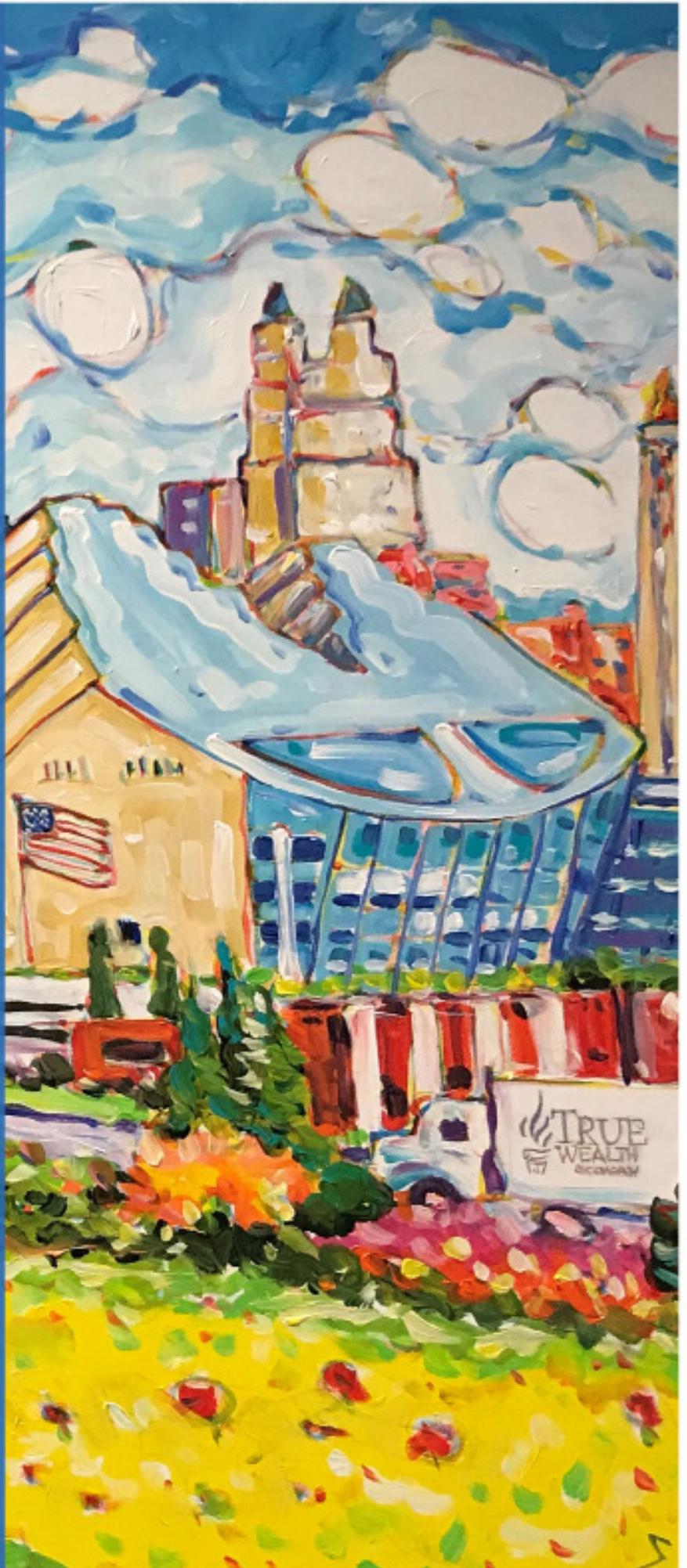




The Importance of Stress Testing Your Wealth Strategies

JUNE 2020
FLASH REPORT





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When making decisions about your money, it can be smart to know the steps that extremely affluent individuals and families take to grow and protect their significant wealth.

Take stress testing, for example. Stress testing is a process that carefully examines your current wealth planning strategies to assess the likelihood that they'll deliver the results you expect in various environments and situations.

The Super Rich (people with a net worth of \$500 million or more) often have stress tests conducted because the tests enable them to make smart decisions, to verify that they likely will get what they want, and to confirm they are dealing with the right professionals. They can also be effective in identifying potential big problems—or possible huge mistakes—so changes may be made proactively.

The good news: You don't have to be outrageously wealthy to benefit from a stress test. In fact, we believe it should be part of most people's due process when vetting financial plans, products and services. In addition to identifying potential missteps in an existing plan or service, it may be able to deliver some peace of mind to the client when the test confirms that a plan is indeed on track.

How stress testing works

A stress test often follows a defined process involving four main steps:

- 1. Profiling.** The process starts with discovery. What are your specific goals and concerns? What problems do you want to solve? What opportunities are you seeking to benefit from?
- 2. Solution evaluation.** Once there is clarity about your goals, objectives, concerns and limitations, various strategies or products can be assessed. There are numerous ways to dissect and evaluate solutions, including:
 - **Working the assumptions.** The assumptions underlying the strategies or products are systematically modified to determine how likely they are to work when the “what if’s” of the scenario change.
 - **Evaluating alignment with goals and objectives.** It's essential to determine how likely the strategies and products likely are to accomplish your goals and objectives. A solution may be high quality and still not deliver the specific results you want or need.



- 3. Analytic comparisons.** Based on the evaluation, alternative solutions might be considered. It can be very useful to conduct analytic side-by-side comparisons of the solutions.
- 4. Recommendations.** At the conclusion of stress testing, recommendations are presented and considered—and the next course of action is decided upon.

STRESS TEST TRENDS AMONG ADVISORS

Because of the power of stress testing, leading professionals are increasingly making it a cornerstone of the way they work with individuals and families.

Consider that a sizable majority—76.8 percent—of 181 senior executives at multifamily offices (organizations that serve wealthy families) call stress tests an important deliverable for their clients.

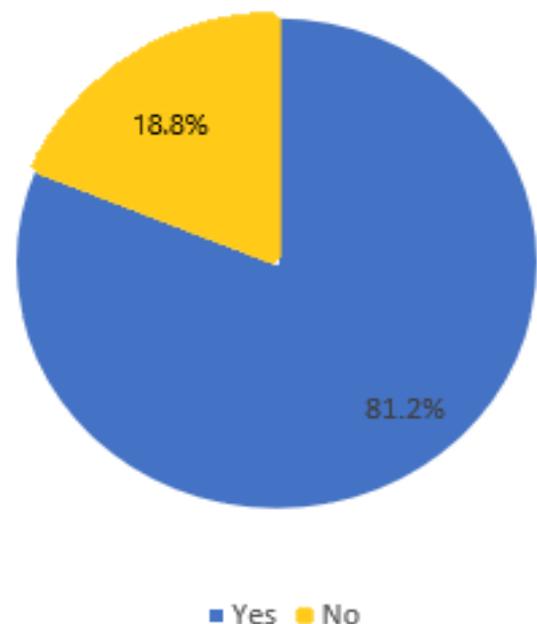
By and large, we see those stress tests focusing primarily on investment management solutions, with other areas like life insurance and wealth planning getting attention to varying degrees.

In our view, this intensive focus on investment management may be too limiting. For example, while just around 40 percent of the executives have stress tested clients' life insurance, a full 64.4 percent of those execs uncovered problems that required corrective actions.

This doesn't surprise us. Many affluent families purchase life insurance to address estate tax concerns. Sometimes life insurance is obtained to create a larger estate, or to make a charitable gift at death. Other times, the intent is to benefit from the tax-free internal buildup. But it's common that some of these affluent families end up with amounts of life insurance that exceed their wants or needs. Additionally, their life insurance may be poorly structured. When life insurance portfolios are not in sync with wealth planning strategies, trouble can occur down the road.

Growing in importance (see chart)

It's reasonable to expect stress testing to garner more interest and attention among clients and their advisors, as evidenced



N = 181 multifamily office senior executives
Source: Family Office Association, 2018



by the fact that more than 80 percent of the executives said these tests will become more important going forward

Stress Testing Will Become Much More Important

One way that stress testing can add value is by evaluating income tax mitigation strategies. Today there are a number of ways to lower corporate and personal incomes (and thereby paying less in taxes). The wealthy may look to stress test these strategies in order to ensure they are not running afoul of revenue services in any way with their approaches.

More access

Stress testing, once a feature available mainly to the wealthiest among us, is increasingly being offered to a broader range of individuals and families. As a result, you may have an opportunity to put your financial strategies, legal strategies, and plans through their paces to determine if they're going to deliver the results you seek.

Next step: Reach out to your financial and/or legal professional to see if a stress test would be a good idea for you.



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913.653.8783 • RETIREWITHTRUE.COM



7450 W 130th Street, Suite 300, Overland Park, KS 66213

