a circle of advice

HOW A GROUP OF WALL STREET WOMEN BEAT THE MARKET

BY **TODDI GUTNER**

WHEN ANN KAPLAN AND HER FEMALE partners at Circle Financial Group (CFG), a private wealth-management organization, slit open their individual monthly portfolio statements these days, they are not nearly as shell-shocked as the rest of us. Unlike the majority of investors who have watched a third or more of their investments disappear over the past year, many of the investors at CFG found parts of their portfolios off only 10%.

Such returns in this down market make CFG seem genius. Not so. The group's success is based on an investment model that Kaplan created seven years ago while she was a partner in wealth management for Goldman Sachs. Kaplan, along with 11 other women, half of whom were Goldman Sachs colleagues, formed a financial support group that allows each member to control her own portfolio while also benefiting from the advice of other group members and outside experts. But what really distinguishes CFG from other investment groups is its members' willingness to bare their souls—and their portfolios—to one another on an ongoing basis.

Because of their experience on Wall Street, the founding members of CFG are each an expert in at least one asset class. CFG's Kaplan is the resident expert on municipal bonds and Jacki Hoffman-Zehner the guru for mortgage-backed securities, while Diane Britz Lotti is the authority on asset allocation. Maria Chrin, a former Goldman wealth manager, is the investment-research specialist.

The Process

THEY MEET REGULARLY

CFG holds weekly investment meetings and quarterly asset-allocation meetings. The group focuses largely on sharing and educating one another about their specific areas of expertise. During their first few meetings members discovered that despite their professional expertise, most didn't have a clear enough overview to organize their financial lives holistically and to manage their own portfolios successfully. "To a large extent the current wealth-management model is broken. Managers either do everything for you or you're left alone to do it yourself," says Hoffman-Zehner.

In their weekly meetings CFG members discuss issues in the current markets and members' individual portfolios. A confidential Web site, phone calls and e-mails help members stay in touch throughout the week. In order to feel comfortable with being completely honest and sharing thoughts and investment allocations, members sign a confidentiality agreement. Beyond the signatures, though, they seem to possess an extraordinary sense of trust in, and collegiality with, one another.

And they are as invested in the long

ILLUSTRATION BY MICHELLE THOMPSON

view as they are in their stock picks. Each member is encouraged to identify her goals, plan what resources she will need, gauge what time frame she has in mind and target the end result.

Many of the women, for instance, have single-stock positions in the financial firms they've worked at. Diversifying out of one of those positions is a frequent topic of discussion. Everyone weighs in with questions that the member should consider. She may be asked: "Have you thought about what you will do with the cash? How does this decision fit into your asset-allocation goals? Have you considered holding on to the stock and shorting it? What about capital gains taxes?" Ultimately all members benefit from the shared stew of opinion, research and previous experience.

THEY DO THEIR OWN RESEARCH

Every three months Chrin and other group members call the managers of the funds that CFG is monitoring and grill them about what each one is doing and why. Before placing a call the member does a lot of due diligence. Subsequently, if the group doesn't understand a particular product that a manager is using, a CFG member will speak with a product specialist. If a manager doesn't make time for the call, the group may recommend not investing there.

Four times a year each CFG member takes a step back and examines her investment allocations, given current market conditions. This process, developed by Britz Lotti, forces members to come to some consensus about the market and possibly make some changes to their portfolios. One woman, for example, had no investments in Japan. The group discussed her reasoning, and she was persuaded to make a small initial investment in a Japanese fund.

CFG recently began to take another look at municipal bonds. Despite a wholesale dump of municipals by hedge funds and brokers and a depressed price, the group didn't think there was anything wrong with their market fundamentals. Kaplan and Chrin ferreted out half a dozen managers and analysts to interview on the subject. Their in-depth research paid off. They added to their municipal portfolios at a time when yields were very attractive and have since made a good return.

Mary Ann Casati recently researched Treasury Inflation-Protected Securities (TIPS) because most members thought they were inexpensive and could provide yield. Her digging uncovered that the yields that were published were incorrect. Casati decided that if she and her partners were to buy them, they should do so for inflation protection only, not for yield.

THEY BRING IN EXPERTS

To continue educating themselves on the latest market issues, CFG brings in experts. Byron Wein, former investment strategist for Morgan Stanley who's now with Pequot Capital and a renowned market bear, has spoken to the group, along with other financial luminaries, such as David Rosenberg, chief economist at Merrill Lynch, who's been touted for predicting the bear economy. All members suggest people to bring in and a committee chooses from the list. Currently, much of the discussion is focused on when the market will recover and what are the best vehicles to invest in until then.

In the summer of 2007 one of the speakers brought in by CFG was the head of derivatives for a major investment bank. He talked about the degree of leverage (debt) that some of his products had—in some instances 30 times leverage (a huge amount in financial terms). The group questioned the wisdom of his strategy, and he said his firm's mathematical models claimed that the bank could go up to 70 times leverage. A discussion ensued. Hoffman-Zehner said that perhaps the mathematical models worked when the market was going up but not when it was going down.

THEY LISTEN TO EACH OTHER

Hoffman-Zehner had been sounding alarm bells on the amount of debt that the housing market was taking on back in 2004. She said if you really "stopped the party, the whole housing market would fall down like a house of cards." She predicted then that Freddie Mac and Fannie Mae would have problems. Visiting experts at CFG meetings began to think that the group was being overly cautious and fearful when they thought the market was fine.

Several members of CFG had a position in an Asia fund that had a mandate to invest in a spectrum of Asian countries. But during a quarterly call with the Asia manager several CFG members determined that the manager had 80% of his portfolio invested in only one country and was short on other Asian countries. When they pressed him about his strategy, the manager said he felt there was an opportunity to be achieved from his decision. CFG members countered that investors hadn't hired him to be a one-country manager. They reported back to the rest of the CFG group, and they ended pulling out of the fund. Following their action the fund fell significantly.

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HEDGE FUND CHANGES

In August 2007 the equity markets began tanking. Chrin and Kaplan were together one day and decided to place a few telephone calls and speak with hedge fund managers with whom they and other CFG

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members had big investments. They wanted to know what each manager thought about the market and what was the most important thing he or she was doing at that moment.

One manager they spoke with surprised them. He told them that he was reviewing all counterparty agreements, i.e., researching trading agreements with every firm he did trades with for his fund, such as Bear Stearns and Lehman Brothers. He wanted to know who really held the money he had entrusted to his trading partners. He made sure that all the trading agreements were written in such a way that if he needed to get his money out quickly, he could.

The fact that the head of a hedge fund was taking the time to do this type of research signaled to Chrin and Kaplan that he was beginning to be worried about the financial stability of these firms. The two women realized that essentially the hedge funding manager was saying that "you had better know who is holding your cash." After he reported his actions to the group, most members decided to stay invested with him. Ultimately, that manager's fund was down only 10% for 2008, while many other hedge funds fell far more.

During the September 2007 quarterly calls, Chrin used the experience she'd had with the hedge fund manager as a template to question other managers. She wanted to know if they were doing the same due diligence with trading partners. Those who were informing themselves, she stuck with; those who weren't, she sold out of. She brought her findings back to the group.

Hoffman-Zehner, who focuses on fixed income, sat in on a quarterly call to another hedge fund and became alarmed when she didn't quite understand the relationships between certain variables. After questioning the manager and being dissatisfied with his responses, she decided to pull her investment. She explained her reasoning to the rest of the group, and between January and July 2007 everyone cashed out. The fund declined significantly.

In the spring of 2008 Bear Stearns faltered and CFG sprang into action. Chrin and other CFG members spoke with more than a dozen research analysts and financial and portfolio experts to get a broad understanding of exactly what was happening and what the implications were for the financial markets. Each member brought in experts to speak with the group, and they were told not to worry. "Stay the course. The market always comes back," the experts advised. But instead of taking them at their word, CFG members decided to examine the firms' balance sheets on their own. They quickly realized that every financial firm had extreme amounts of debt. Many of the women made a decision to sell concentrated single-stock positions, hedge funds and high-yield debt whenever the market rallied.

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So the women of CFG have kept their very astute heads as the stock market has faltered this past year. And while most investors don't have access to the caliber of information that CFG members do, there are some lessons to be gleaned from their system.

Applying the Model

First, create your own big picture: Where do you want to be in 5 years, in 25 years? How much money would you need to sustain your lifestyle? Assess what you own and how much you spend. Figure out what your income, capital and expenditures are and what they will likely be. Next, design an asset-allocation model based on what you determine to be your needs and what percentage of return you would reasonably like to see, in line with current market trends.

"When we study what diminishes wealth, down markets and manager selection are not key figures," says Kaplan. Instead, it is lack of diversification, overspending and borrowing too much. Build an effective checklist for your road to a healthy portfolio that includes planning, diversifying, monitoring investments, securing tax efficiencies and arranging for appropriate wealth transfer. "All these factors have one thing in common," says Kaplan. "They are all things we can control."

And once we factor in control, Wall Street wizardry may be a less essential ingredient in preserving and building wealth, according to the CFG model, than the very womanly qualities of attention to detail and the sharing of strengths. •

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