7 principles for strategic wealth creation

The traditional model of managing a diversified portfolio rarely creates wealth these days. A strategic, individualized approach is needed.

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Banks and brokers, stocks and bonds: These are the ingredients of traditional investing — but currently they tend to preserve rather than create wealth. This is because no matter how well thought-out your portfolio, investment expenses, taxes and inflation will ultimately impact your attempts at wealth creation.

Yet wealth creation is very much within reach, say the authors of the book, *The Empowered Investor: 7 Principles for Strategic Wealth Creation in a New Financial World*. But it requires deviating from the standard investment paradigm and entering the realm of strategy.

In this new approach, Cuno Puempin, Heinrich Liechtenstein, Fariba Hashemi and Brian Hashemi outline seven strategic principles to help investors take control of their capital and maximize their returns.

Involve the investor

After all the recent shakeups caused by the global financial crisis, it seems unlikely that the investment industry would suffer from inertia, yet it does. An overreliance on mathematical formulas, based on the normal distribution of a bell curve, is one of many flawed approaches.

Reality fits the bell curve poorly, especially when surprising, "black swan" events throw the markets into a tailspin. Financial advisers tend to create generic investment recommendations based on analyzing opportunities quantitatively.

This advice neglects the immense value of clients' personal knowledge, skills and resources.

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These should be at the heart of any successful investment endeavor, not mathematical models and brokers. Investors should build strengths and core competencies that enable them to invest successfully.

Elements of strategy

Strategy in investment is based on the same essential elements as in business, the military or politics: Success depends on the optimal use and deployment of resources in order to achieve an objective.

The authors propose a framework with the following seven highly interconnected principles and provide specific considerations for each.

1. *Build on core strengths and competencies*. This is the essence, the raw material needed to help investors succeed.

2. *Exploit opportunities*. Build on your knowledge of a specific field. Scan the environment, and be sure to take a long-range view.

3. *Make use of networks*. Keep core competencies at the heart of the network. Do not overlook the importance of weak ties.

4. *Apply an investment approach that differentiates you from others*. Decide where you want to differentiate: A niche asset class, industry or geography? Build core competencies that differentiate you, and apply an indirect approach.

5. *Prevent threats and understand how to handle risks reasonably*. Threats and risk may inevitably lead to losses. Manage them through rigorous analysis and careful selection of core competencies that need to be developed.

6. *Fit the time dimension by observing trends and cycles*. Timing is crucial. Be sure to think in cycles. Apply the big picture, and clarify your investment horizon. Also, ensure strategic flexibility. Be creative and courageous, but also patient.

7. *Execute with efficiency*. Avoid or reduce fees and implement your strategy at a low cost. Watch out for opportunity costs.

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Putting it into action

With these principles in mind, investors should distribute their investment over four sub-portfolios, according to their age, aspiration and level of risk aversion.

1. *The focus portfolio*. This is where the investor, due to his or her outstanding strengths, intends to create value.

2. *The security portfolio*. These funds are invested in highly secure and liquid asset classes.

3. *The diversification portfolio*. The diversification adds to security, yet also generates some dividend and interest income.

4. *The opportunity portfolio*. These are small investments geared toward exploiting special opportunities.

An effective strategy should contain the following elements:

- the investor's vision and core competencies;
- the structure of the investment portfolio;
- management of threats and risks;
- the investor's intended network;
- cash and liquidity guidelines;
- priorities regarding allocation of resources; and
- a legal and tax structure.

March to the beat of your own drum

Investors who wish to create rather than preserve wealth should aim toward annual returns of 10 percent or higher. Investors cannot achieve this by listening to their bankers or following traditional stock/bond recipes.

Successful investors are those who have marched to the beat of their own strengths and competencies to create wealth. In doing so, they have brought wealth creation from the realm of the elusive to that of the tenable. *The Empowered Investor* illustrates this concept with real-world case studies and interviews with highly successful strategic investors.

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