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Private View Blog: Accelerating change in family offices

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Family offices are changing as they respond to the economic effects of the coronavirus, the rise of ESG investing and make increased use of outside experts. While they may present challenges to traditional asset managers, these changes are creating opportunities for family offices

A fundamental reconsideration of strategic asset allocation is occurring. It is driven by changing return expectations, ESG (environmental, social and governance) investing and the economic impact of the coronavirus. In addition to spurring discussions regarding the importance of resilience, the role of specific assets is also being examined, including bonds, non-listed assets and private transactions.

In light of the changing nature of bond markets, coupled with very low or negative yields, many family offices are now confining their bond exposure to specific strategies, such as credit crossovers and emerging market debt. But a larger trend is also underway, as many family offices would prefer that their investment strategy emulates the endowment model, which can benefit from the illiquidity premium and incorporate direct access to private transactions. It implies a smaller allocation to core fixed income and larger allocations to hedge funds and private capital.

I believe that non-listed assets can reliably represent between 20 to 40 per cent of a family office's asset allocation. There are stiff challenges ahead, of course, but focusing on long-term performance drivers, strict rebalancing and operational discipline will pay off.

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Complexity can be a deterrent for family offices to position tactically. And it is a challenge to positively operate with the stop and go effect of the epidemic cycle on markets. Investment success rests in the capacity to move at critical moments. Unfortunately, it is all too common for managers to become paralysed by news flow. The ability to make tactical moves also entails owning assets that can be quickly liquidated, having a cash buffer and employing hedging strategies. I typically advise family offices to also take advantage of their typically long investment horizon to move into devalued assets.

Resilience amid a pandemic and economic recession

In the face of the coronavirus pandemic, resilience is seen on all sides. There is consolation in the observed resilience of economies. But resilience is also seen in the flexibility of central banks, the response by states and the swift adaptation in the private sector. New risks have emerged, but there is also new-found capacity to cope with these risks.

Perhaps the only silver lining is that the coronavirus economic shock has led family offices to more carefully consider tail risks, such as by preparing for future sudden stops in markets or economies. A cyber attack, for example, could have even more significant and longer-term consequences than what is now seen with the coronavirus pandemic.

Good governance will foster future resilience at family offices. But you know if you are resilient only if you survive. Nonetheless, you can lay the groundwork with a structured investment process. Practically, this entails a clear Initial Policy Statement and a broad awareness of risk and risk pricing. A structured investment process and a clear statement regarding goals and strategies can go a long way in supporting tactical positioning and building long-term portfolio resilience.

Management resilience is the result of many soft skills, and family offices have a built-in advantage compared with traditional, larger institutions. This is based on the social aspects of family offices, given a shared purpose, respect between shareholders, trust and parental stewardship.

Tailored ESG investing

Family offices are increasingly customising ESG portfolios in line with their own ethics, beliefs and interests, challenging the top-down solutions proposed by large institutions. Religious foundations, active for many centuries in what is now called impact investing, have different needs, as they fund the areas of education, health and social enterprises and concentrate more on non-financial returns.

Indeed, the Covid-19 crisis has blurred the challenge of ESG performance. It may have been more the defensive nature of these investments that rewarded ESG strategies in 2020 than a pure ESG factor.

Outperformance also has to be viewed over a long track record, full economic cycles and the up and down of ESG cycles. Family offices would do best to concentrate on the ‘governance’ factor when evaluating ESG investments. It is the most relevant and will determine the approach to environmental and social issues.

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Nurturing diversity to unleash potential

Family offices exist to exert control in managing assets and to align their management to the needs of the asset owners. It provides an opportunity to pursue separate, tailor-made strategies rather than the ready-made solutions proposed by large institutions. Here, independent advisers can add value within advisory boards, bringing diversity in terms of views and experience. Such access to experts is one more challenge to the traditional model of a private-bank CIO taking unilateral decisions.

Outside experts can enrich the decision-making processes at family offices and offer access to expert platforms supplemented by powerful data and analysis. A fresh perspective and new ideas are especially needed as family offices face the extraordinary situation of a global epidemic, economic recession and the distortion in asset valuations by central banks. I am convinced that despite current challenges, family offices are in an advantageous position to adapt to and benefit from these extraordinary times.

Didier Duret is serving as a non-executive director on the board of directors of Neuflize Vie SA, is a member *of the investment committee at Omega Wealth Management and Halkins Investments LPP and holds several independent advisory positions at private family offices and foundations. He also promotes governance research and good practices with his fellow INSEAD Alumini with ID29 Think Tank. Didier Duret was interviewed on 4 November 2020 at the Annual FT Wealth Management Summit by Owen Walker, FT European Banking correspondent.*