

3-Dimensional Alpha: Value Added

BY MONROE M. DIEFENDORF, JR., CIMA[®],
CLU, ChFC, CFP[®], RFC[®], C3DWP[®],
AND JEREMY P. DONOVAN

Wealth management is more than money management. Financial, personal, and social wealth comprise one's total wealth. If each dimension of our wealth has a value, then preserving and protecting each becomes an important part of the total wealth-management process.

Financial-wealth rating (ϕ). A measure of how the advisor enhances the client's returns relative to risk vs. reward.

Personal-wealth rating (π). A measure of the permanent preservation of a client's wisdom, beliefs, and values for future generations (legacy) as provided through specific strategies created by the advisor.

Social-wealth rating (σ). A measure of how the advisor amplifies gifting through charitable planning strategies (philanthropy).

When an advisor can add value and synchronize all three of these dimensions, the advisor's value is not simply geometrically increased, it is exponentially amplified. This holistic advisor significantly reduces the prospect of being replaced as a result of his or her investment performance results.

But how does a client determine if an advisor can provide total-wealth management solutions? The authors have created a formula, the 3-dimensional alpha ($3D\alpha$), that can be used to determine if an advisor

can provide more than simple money management services.

In creating $3D\alpha$, the authors assumed the following properties to be measurable:

- The client's self-assessed degree of desire for a trait or skill used in providing 3D wealth-management services (3D wealth-client demand score)
- The advisor's use of proven strategies and constructs designed to provide 3D wealth-management services (3D wealth-practitioner rating)

These values will be measured using the 3D Wealth Client Demand Survey and the 3D Wealth Practitioner Survey.

The survey says...

The 3D Wealth Client Demand Survey¹ is conducted electronically and consists of 30 comparative multiple-choice items and one free-response item. The multiple-choice items introduce a resource to be allocated (e.g., time, money, importance) and two possible outlets to spend that resource. These two options come from two different wealth dimensions. Clients are given eight possible responses: definitely choice A, very likely choice A, likely choice A, choices A&B are equal, likely choice B, very likely choice B, definitely choice B, or neither A nor B are important to me. Questions are grouped in threes so that each dimension can be paired against the other dimensions in an apples-to-apples comparison. This is illustrated best by an example of a question group:

1A) IT IS MOST IMPORTANT TO ME THAT...

A) I pass on my beliefs and philosophies to my family.

or

B) I maximize the financial amount I leave to my family.

1B) IT IS MOST IMPORTANT TO ME THAT...

A) I pass on my beliefs and philosophies to my family.

or

B) I teach and model philanthropy to my family.

1C) IT IS MOST IMPORTANT TO ME THAT...

A) I teach and model philanthropy to my family.

or

B) I maximize the financial amount I leave to my family.

Using a survey that is structured this way, the client can indicate priorities accurately by making like comparisons across all three dimensions. The free-response question asks a client to divide hypothetical lottery winnings among several possible recipients across all three dimensions of wealth. This is a directly quantifiable self-evaluation of wealth-management priorities. These responses then are converted from comparative responses and free-response questions to individual numerical scores using the 3D wealth-client survey score conversion formula.² The resultant conversions will give a client three different demand scores: the finan-

>> “3-DIMENSIONAL ALPHA” CONTINUED

cial wealth-management demand score (F-score), the personal wealth-management demand score (P-score), and the social wealth-management demand score (S-score). Each score can range from 0 to 1.0, where 0 indicates no demand for management in that dimension and 1.0 indicates the highest possible demand for management in that dimension. When the F-score, P-score, and S-score are added together, a client has discovered his or her 3D wealth-management demand score, 3Dα. This score will fall between 0.0 and 3.0.

An advisor finds his or her 3D wealth-management practitioner ratings by taking the 3DW Practitioner Survey.³ The survey asks an advisor to examine his or her practices and methodologies for providing a client with advice in a particular dimension. Responses affect an advisor’s financial-wealth rating, personal-wealth rating, and social-wealth rating. Each response of “yes” adds 0.1 to an advisor’s rating. Among the 30 items in the survey are 10 items each concerning financial, personal, and social wealth. Therefore, an advisor’s maximum rating in each dimension is 1.0, and the highest possible overall practitioner rating is 3.0.

3-Dimensional Alpha: The Formula

Calculating the 3Dα is a simple process once the client’s scores and the advisor’s ratings have been calculated. The client’s F-, P-, and S-scores are used as coefficients in the following trinomial:

$$F\phi + P\pi + S\sigma = 3D\alpha$$

In this formula, an advisor’s ability to provide wealth management in a particular dimension is weighted against a client’s demand for that ability. For example, if a client has a 0.2 F-score (relatively low) and an advisor has a 0.9 φ-rating (very high), an alpha is increased by only 0.18 in the financial dimension. The same advisor, when paired with a client with a 0.8 F-score (relatively high) increases the alpha by 0.72 in the financial dimension. Let’s examine a few hypothetical pairings to give a feel for how 3Dα indicates compatibility between advisor and client.

<u>Client 1</u>	<u>Advisor 1</u>	<u>Advisor 2</u>
F-score : 0.6	φ-rating : 0.4	φ-rating: 0.4
P-score : 0.1	π-rating : 0.9	π-rating : 0.3
S-score : 0.8	σ-rating : 0.5	σ-rating : 0.8

$$\begin{aligned} \text{Financial} + \text{Personal} + \text{Social} &= 3D\alpha \\ 3D\alpha \text{ for Client 1 and Advisor 1} &= \\ (0.6)(0.4) + (0.1)(0.9) + (0.8)(0.5) &= 0.73 \end{aligned}$$

$$\begin{aligned} 3D\alpha \text{ for Client 1 and Advisor 2} &= \\ (0.6)(0.4) + (0.1)(0.3) + (0.8)(0.8) &= 0.91 \end{aligned}$$

While Advisor 1 is more-highly rated overall than Advisor 2 (1.8 to 1.5), Advisor 2 has a 25-percent higher 3Dα with Client 1 based on compatibility. It is worth noting that neither advisor meets the client’s demands in the financial dimension, so a third advisor who rates highly in both φ and σ would score significantly higher than either Advisor 1 or Advisor 2 .

Consider Client 2, who has completed the 3D Wealth Management Demand Survey to arrive at a personal score. Both Advisor 3 and Advisor 4 complete the advisor survey to determine their 3D wealth-practitioner ratings.

<u>Client 2</u>	<u>Advisor 3</u>	<u>Advisor 4</u>
F-score : 0.7	φ-rating : 0.8	φ-rating: 0.7
P-score : 0.3	π-rating : 0.9	π-rating : 0.3
S-score : 0.5	σ-rating : 1.0	σ-rating : 0.6

$$\begin{aligned} \text{Financial} + \text{Personal} + \text{Social} &= 3D\alpha \\ 3D\alpha \text{ for Client 2 and Advisor 3} &= \\ (0.7)(0.8) + (0.3)(0.9) + (0.5)(1.0) &= 1.33 \end{aligned}$$

$$\begin{aligned} 3D\alpha \text{ for Client 2 and Advisor 4} &= \\ (0.7)(0.7) + (0.3)(0.3) + (0.5)(0.6) &= 0.88 \end{aligned}$$

This case is interesting because both advisors meet or exceed the needs of the client in every dimension. Clearly, Advisor 3 is the highest-rated advisor in this example and also yields a higher 3Dα. Would this be the best choice for the client? It’s hard to say without knowing other variables (cost, rapport with client, etc.).

Compatibility Counts

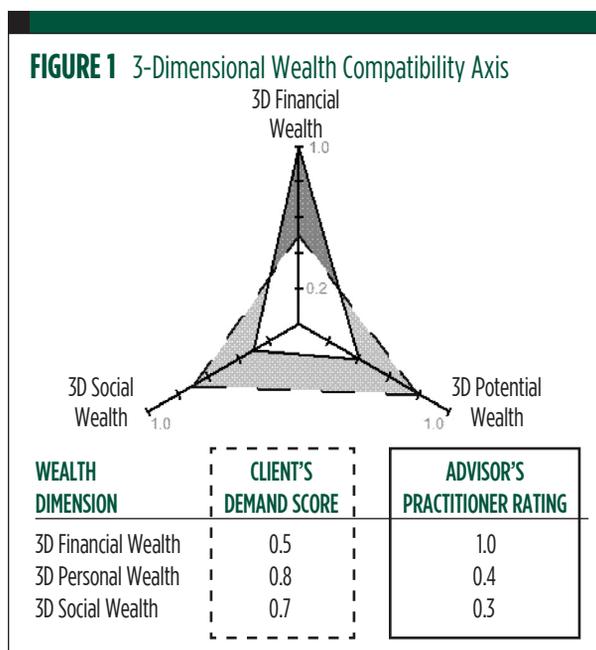
A client with maximum need (a 3.0 3D client-demand score), when paired with an advisor of maximum skill (a 3.0 3D wealth-practitioner rating) will yield the highest possible 3Dα 3.0.

$$\begin{aligned} \text{Financial} + \text{Personal} + \text{Social} &= 3D\alpha \\ (1.0)(1.0) + (1.0)(1.0) + (1.0)(1.0) &= 3.0 \end{aligned}$$

In fact, an advisor with a 3.0 3D wealth-practitioner rating always will give a client the highest 3Dα possible for that client. However, this may not always be the most cost-effective 3D wealth-management solution for a client. To provide the client with the maximum amount of compatibility information, the authors have devised a second compatibility tool, the 3D wealth-compatibility axis. This tool shows quickly and simply whether a client’s needs may be met by a particular advisor. Consider the example in figure 1.

In figure 1, a client’s demands are graphed with a dotted line and an advisor’s ratings are graphed with a solid line. The vertices of each triangle are placed at the score or rating for the corresponding dimension. The dark-gray region visually represents a dimension in which the advisor’s practitioner rating exceeds the

FIGURE 1 3-Dimensional Wealth Compatibility Axis



client's demand score. Conversely, the light-gray region shows dimensions where the advisor's abilities do not meet the client's demands. When considering an advisor, both the 3D α and the 3D wealth-compatibility axis should be considered. In doing so, a client will be certain to choose an advisor that can provide the best-possible 3D wealth-management while avoiding paying for more advice than they need.

From Theory into Practice

Clients face a major challenge choosing among qualified advisors in today's financial market. These rating tools can minimize a client's anxiety and intimidation with the advisor-selection process. Demand scores provide organized thoughts and an accurate diagnosis of areas of greatest need so that a client can enter into the total-wealth management process with direction and purpose. Everyone feels more prepared when they've done their homework. Being prepared inspires confidence, which in turn leads to good decision-making and fewer regrets. A 3D wealth-practitioner rating is not just a tool for the client in evaluating an advisor. Ratings can act as a useful measuring stick by which an advisor rates himself among his peers. Think of it as a golf handicap in total-wealth management. These ratings also allow an advisor to offer an independent, objective evaluation of his or her abilities to potential clients. Advisors are less reliant on a sales pitch and a first impression when they have a rating to set them apart. The practitioner ratings also can point out areas where professional growth is required. If one intends to be effective in the total-wealth marketplace, there is no room for weakness in a particular dimension. By quantifying excellence in these areas, the 3D wealth-practitioner ratings give direct measurable feedback concerning areas for improvement.

The Matchmaker!

Used in tandem, a 3D wealth-client demand score and a 3D wealth-practitioner rating yield a 3D α , uniting an educated client with a qualified advisor. How many clients end up with advisors who don't meet their needs? How many advisors waste valuable time meeting with clients who are looking for things they don't offer? Successful wealth-management partnerships can be determined before the client sets foot in the advisor's office. 3D α is a strategic matchmaking tool for the total wealth-management arena. M

Monroe "Roey" Diefendorf, Jr., CIMA®, CLU, ChFC, CFP®, RFC®, C3DWP®, is chief executive officer of Diefendorf Capital Planning Associates in New York, NY. He earned a B.A. in psychology from Bucknell University and an M.A. in insurance from Georgia State University, with a major in estate planning and a minor in pension planning. Contact him at roey@diefendorfcapital.com.

Jeremy P. Donovan is a teacher of mathematics and physics at the Academy of the Pacific Rim in Hyde Park, MA. He attended North Carolina State University and earned a B.S. in mathematics from Campbell University. Contact him at jdonovan@pacrim.org.

Endnotes

- To obtain a copy, contact the authors.
- For all $x < 4$, such that x represents a quantitative value assigned to a client's response to a survey item. Responses are valued as follows: definitely choice A = 1, very likely choice A = 2, likely choice A = 3, choices A&B are equal = 4, likely choice B = 5, very likely choice B = 6, and definitely choice B = 7

$$-\frac{1}{2} \left(\frac{1-x}{3} + 1 \right)^{\frac{3}{4}} + \frac{1}{2} = y; \quad 1-y = z$$

For all $x \geq 4$, such that x represents a quantitative value assigned to a client's response to a survey item. Responses are valued as follows: definitely choice A = 1, very likely choice A = 2, likely choice A = 3, choices A&B are equal = 4, likely choice B = 5, very likely choice B = 6, and definitely choice B = 7

$$\frac{1}{2} \left(\frac{x-1}{3} - 1 \right)^{\frac{3}{4}} + \frac{1}{2} = y; \quad 1-y = z$$

Where y represents the amount used for the dimension corresponding to choice B and z represents the amount used for the dimension corresponding to choice A in the following summations.

$$0.9 \left(\frac{\sum y + \sum z}{20} \right) + 0.1 [.01 \sum m] = \text{Client Demand Score}$$

(m represents any value assigned by client to a recipient in the free-response question corresponding to the dimension being calculated)

The above formula will be calculated for each dimension's demand score.

- To obtain a copy, contact the authors.