2018 marks the 200th anniversary of the founding of Brown Brothers Harriman (BBH) and our 200th anniversary of working with families and businesses to help protect and enhance their wealth. Firm capital and individual capital are one and the same in a general partnership, and BBH has been in the business of managing wealth since its inception. The first recorded instance of BBH managing money for an outside client took place in 1857, when a wealthy mill owner in England sold $153,000 worth of British securities and asked Brown Brothers to invest and manage the proceeds in U.S. securities. In 1882, BBH acquired a seat on the New York Stock Exchange, enabling the firm to trade securities directly on the exchange for its clients.

More formally, Partner Prescott Bush started a fee-based investment advisory business in 1931. His first client was the Harriman family, who had just merged with Brown Brothers & Co. The middle of a depression was an unusual time to begin providing wealth management advice, but Bush had a simple message for families worried about their wealth: “Why don’t you let us manage it for you? We’re doing it for the Harrimans, our own partners. … We can do it for you just as we’re doing it for ourselves.” This alignment of interest between the firm and its clients abides to this day.

Our long history of managing wealth encompasses 44 recessions, as well as countless bear markets, interest rate environments, tax regimes, inflation cycles, wars and investment climates. Navigating these challenges has required a combination of creativity and innovation, underpinned by a focus on client service and the conviction that preserving wealth is the first step toward growing it. A firm does not get to celebrate a bicentennial without evolving along with the economy and marketplace. In the commentary that follows, we look back at the past few decades to explore how BBH has helped its wealth management clients navigate through constant change.
A Brief History of Financial Markets

A typical BBH private client in the 1960s and 1970s had a traditional portfolio comprising 60% large-capitalization domestic stocks and 40% municipal bonds or cash. Precise asset allocation would vary from client to client, depending on the need for income, desire for growth or proximity to retirement, but the asset classes deployed in pursuit of those investment objectives were limited to domestic stocks, bonds and cash.

BBH Partner Brian Berris recalls joining the Chicago office in 1973 as the S&P 500 stood at 112. With the index around 2,700 today, equity investors have earned a compound rate of return of 7.2% over the past 45 years, or 10.4% if dividend income is taken into account. “In retrospect, that seems like a smooth path to riches,” Berris mused recently, “although the path was anything but assured.” As the nearby graph illustrates, the stock market has experienced several sharp reversals over this period, yet the power of compounding worked powerfully for investors who stayed the course. One dollar invested in the S&P 500 on New Year’s Day in 1973 would have grown to $85 today.

Equities have been such a strong engine of wealth creation that one of the seminal events of the past 50 years – Black Monday – is hard to see on the graph. On Monday, October 19, 1987, the Dow Jones Industrial Average shed 23% of its value in a single trading session. Berris remembers ordering pizza for the whole office that day and manning the phones until every single client had been contacted and assured that the world was not ending.

Yet this analysis of historical returns ignores a critical dynamic – inflation. In our earlier example, we observed that a dollar invested in stocks in 1973 would have grown to $85 today, but adjusted for inflation that figure would only be $15. This is still a fifteenfold real return on investment yet illustrates the challenge that inflation – even at modest levels – poses to the goal of wealth preservation.

Throughout this period, BBH has sought to add additional asset classes to client portfolios to help insulate against the threat of inflation while providing greater diversification and broader exposure to investment opportunities.

Bonds have created wealth over this period as well, particularly once Federal Reserve Chairman Paul Volcker (appointed in 1979) broke the spiral of inflation and ushered in a long era of falling interest rates. Ten-year government Treasury yields in 1972 were 6%, climbing to 16% in 1981 before beginning a long slide to a record low of 1.3% in 2016. Mortgage rates peaked along with bond yields in 1981 at around 18.5%.

The steady decline in interest rates boosted the housing market as well as bond prices, so investors enjoyed a triple boost to their balance sheets as equities, fixed income and real estate all rose in value.

The outside of BBH’s former New York headquarters at 59 Wall Street.
Investment Innovation

The first foray into an additional asset class took place in-house. BBH has served as banker and lender to middle-market companies throughout its history, so it seems inevitable that at some point the firm would provide equity capital in addition to the debt capital offered through its traditional banking practice. The firm launched its first private equity offering in 1989. Investors in this 1818 Fund I were primarily institutional, but by the 1993 launch of 1818 Fund II, the wealth management business was able to aggregate private client commitments into representing between 10% and 20% of the fund.

The firm’s private equity practice was rechristened BBH Capital Partners in 2006, and private clients and principals of the firm represented the majority of invested assets. That alignment of interest and capital differentiates the BBH approach from other private equity firms, as does the strategy for deploying capital. Rather than depend on investment banks and an auction process, BBH relies on a well-established ecosystem of private companies and owners to source investment ideas. This results in fewer, but better, investment opportunities.

While the private equity business was taking shape, the firm was also looking for ways to invest outside the United States in response to growing client demand for non-dollar assets. In the early 1990s, BBH’s International Equity Group managed money for several institutional clients, and this led to the launch of an international equities strategy in 1997. As with private equity, the primary audience for this fund was the firm’s own wealth management clients. Portfolio managers and analysts based in New York, London and Tokyo applied the same fundamental analytical approach as their domestic colleagues and shared research on global economic and market developments that influenced domestic as well as international assets.

Around the turn of the 21st century, growth of the wealth management business challenged a model that relied on portfolio managers in each office to construct portfolios from a list of approved securities. Jack Borland, the Partner who led the business at that point, notes that “it was clear that centralizing the management of equity portfolios was necessary. Client experiences varied too widely, and we needed to free up our managers’ time to focus on asset allocation, the introduction of new asset classes and client service. It was the only way to grow our business without damaging the client service approach for which we were known.” The business undertook the effort to transition portfolio managers into relationship managers charged with taking a more holistic approach to helping preserve and grow their clients’ portfolios.

Steps were taken in this direction in the early years of the 2000s and came to full fruition when Partners Rick Witmer and Tim Hartch assumed management of the centralized Core Select portfolio strategy in 2005. The Core Select approach was both old-fashioned and innovative at the same time. Witmer and Hartch, along with their team of analysts, sought to find companies that sell essential products and services, generate robust free cash flow on the strength of strong balance sheets, enjoy a sustainable competitive advantage and trade at a discount to the intrinsic value of the business. The Core Select idea was, in a way, simply a private equity approach to public equity markets, a philosophy resonant with the firm’s private equity activities as well as Witmer’s and Hartch’s prior experience in that asset class.
A careful investment approach helps clients pursue those goals, and over the years we have complemented our investment offerings with other services designed to help further preserve, protect and grow our clients’ wealth.”

The subtly innovative idea behind this strategy is that successful investing is not an exercise in price anticipation, but in value recognition. We define risk as the possibility of permanent capital impairment, and long holding periods allow for the power of compounding to work in a tax-efficient way. This remains the Core Select philosophy today under the management of Partner Michael Keller.

The evolution of financial markets and investment solutions brought BBH’s private wealth business to a fork in the road about 15 years ago. To meet growing client demand, we either had to develop new investment strategies ourselves or partner with third-party investors to allocate capital into new asset classes. Rather than try to be all things to all people, the firm decided to stick to those asset classes where it had a core competence and outsource management where it didn’t. The first application came in 2004 when we chose to outsource the management of our international equities strategy and appointed two subadvisors to manage the portfolio.

In the same way that our private equity practice informed the development of the Core Select philosophy, so, too, did the success of Core Select lay the groundwork for building out our network of third-party managers. Rather than adopt a completely open architecture approach, in which all investment decisions are outsourced, we opted for a hybrid approach, in the belief that remaining a disciplined and active investor allows us to more readily identify those traits in other managers.

What are the characteristics of a good investment manager? First, we want the principal investors at outside managers to have a lion’s share of their own wealth at risk in the same investment strategy that we are making available to our clients. This alignment ensures focus and leads to a second characteristic. Since they have their own capital at risk, our managers – like our colleagues in private equity and Core Select – define risk in absolute terms. If the ultimate objective of investing is to preserve and grow wealth, then falling behind an index from time to time does not represent real risk. Losing money does.

Most institutional money managers define risk as the possibility of deviating from an index, and they manage that risk by diversifying portfolios to the extent that they often mimic the benchmark. An investor who defines risk in absolute terms, however, manages risk through concentration. She wants to know the companies in her portfolio in such depth that she has the courage of her conviction to hold or even put more money to work in periods of market volatility. Good investors know what they own and why they own it, and that naturally leads to more concentrated positions.

Finally, we partner with investors who appreciate the importance of capacity. Every investment strategy is subject to the law of diminishing returns at some point, where the marginal dollar of committed capital requires a dilution of investment discipline. We want managers to be thoughtful about those constraints and close their practice to new inflows of funds as they approach capacity. Why would investors ever refuse new funds to manage? Because the driver of their own bottom line is not asset gathering, but the funds they already have invested in the same strategy as our clients. This alignment of interest is vanishingly rare in the investment management world and requires discipline and creativity to find.

The BBH Private Banking business today offers access to a wide variety of asset classes through its Wealth Strategies platform of third-party managers, now including some asset classes where BBH has an internal solution as well. As our business grows and markets evolve, we intend to keep expanding this platform, albeit at a thoughtful pace.
Previously disparate practices, such as those outlined in the preceding paragraphs, were brought together under cohesive leadership and a single objective of helping our clients build, preserve and transition wealth, regardless of whether the wealth takes the form of a business or a financial portfolio.”

Whereas a firm doesn’t get to be 200 years old without innovating, nor does a firm survive for 200 years by chasing every new thing that Wall Street cooks up. Our history includes more than a few dodged bullets, such as underwriting securities in the years before the Great Depression or investing in subprime securities in the 2000s. Financial innovation is a double-edged sword, and we are cautious and thoughtful before embracing new financial products for our Private Banking clients.

In his 2002 letter to shareholders, Warren Buffett famously claimed that “derivatives are financial weapons of mass destruction, carrying dangers that, while now latent, are potentially lethal.” Buffett was proven tragically right (and prescient) when opaque counterparty risk in the derivatives market crashed the economy and markets a few years later. BBH clients suffered from the bear market of 2008-2009, but not nearly as much as the broad indices, and their portfolios therefore recovered more quickly.

In a similar vein, former Fed Chairman Volcker addressing a Wall Street audience in the wake of the financial crisis stated, “The most important financial innovation that I have seen in the past 20 years is the automatic teller machine.” Innovative financial products are often designed to enrich the issuer rather than the investor, and the age-old caveat of “buyer beware” is worth remembering. The list of investment fads that we have avoided is long. Among the rogues’ gallery of investment products that caused far more harm than good over the past few decades are variable rate annuities, margin trading, collateralized debt obligations, portfolio insurance and today’s cryptocurrencies.

Our success, and the success of our clients’ portfolios, is driven as much by what we’ve avoided as by what we’ve embraced.

The Bigger Picture

A culture of investing lies at the heart of our firm and our Private Banking business, yet we never forget that money is a means to an end. We spend a fair amount of time with our clients in order to understand what their ultimate objectives are regarding retirement, lifestyle, legacy, philanthropy and so forth. A careful investment approach helps clients pursue those goals, and over the years we have complemented our investment offerings with other services designed to help further preserve, protect and grow our clients’ wealth.

In 1984, BBH created its first trust company in New York so that the firm might act as fiduciary in client matters, administer trusts and execute estates. A few years later, the firm established a trust company in Grand Cayman to meet the needs of its non-U.S. clients.

As trust laws evolved, so did our trust structures and services. Although much trust law is set at the state level, when the Office of the Comptroller of the Currency allowed for the creation of national trust banks – which can serve clients throughout all 50 states – BBH followed suit by establishing a national trust bank in 2006. Trust law in the state of Delaware remains particularly advantageous for trustees, so BBH established a trust company in Wilmington in 2009 to allow clients access to those benefits. Clients today have access to a variety of trust services and structures at BBH, depending on their needs.

With trust companies come former practicing trust and estate attorneys, and over time we have focused some of those individuals on helping clients organize and protect their wealth. These wealth planners – all former practicing lawyers with experience in trust and estate law – work side by side with a client’s relationship manager to ensure that the investment planning is well integrated with tax and estate planning. Uncoordinated planning can pose both real and opportunity costs. Clients appreciate this integration, and further appreciate the advice of an advisor who does not bill by the hour but can take the time to thoroughly understand a client’s objectives and make sure that the planning aligns with those.

Three years ago, one of our wealth planning professionals concluded that the wealth management profession was underserving women. The combination of an aging baby boomer population and longer life expectancies for women than men implies that women will end up making more and more financial decisions as they age but are often unprepared to do so. At the same time, we observed that the ranks of women entrepreneurs were rapidly rising and creating wealth of their own. Recognizing the opportunity to serve the specific needs of these two groups
of women investors, BBH launched the Center for Women & Wealth (CW&W). This effort now hosts a dozen events a year and publishes BBH’s quarterly Women & Wealth Magazine.

The CW&W conducts research and publishes insight into issues of interest not just to women, but for families in general. The biggest obstacle to the multigenerational preservation of wealth is not bear markets, recessions or taxes, but the ability of future generations to appropriately steward the family wealth – hence our focus on next generation education.

Over the past few years, BBH has pioneered a suite of materials to help families align their wealth with their values and include younger generations in that exercise as part of the effort to transition both wealth and values to the next generation. In addition to using these materials, we sponsor events for our clients’ children and grandchildren to make sure they are receiving the appropriate education about the opportunities and challenges that wealth poses.

The source of wealth for many Private Banking clients is or was a private business, and, as a private business itself, BBH is uniquely qualified to address issues that accompany business ownership. Indeed, for some clients, their company is far more significant than their financial portfolio. Our Corporate Advisory & Banking practice evolved from our mergers and acquisitions business and now advises clients who own companies on matters such as strategic growth initiatives, succession planning, appropriate capital structure and acquisition or sale strategies.

Managing a business is hard, and even harder when family dynamics intrude. In recognition of the tricky issues that lie at the confluence of family and business, we launched the BBH Center for Family Business (CFB) just this year. The CFB provides insight and advice on a range of topics related to family business ownership, based on years of practice and the vicarious experience of working with hundreds, if not thousands, of family businesses.

Perhaps the biggest innovation in the history of our private client practice was the decision to bring all these capabilities under one roof in 2014 by creating BBH Private Banking. Previously disparate practices, such as those outlined in the preceding paragraphs, were brought together under cohesive leadership and a single objective of helping our clients build, preserve and transition wealth, regardless of whether the wealth takes the form of a business or a financial portfolio. BBH Private Banking today provides an integrated, customized offering comprising lending, private equity, wealth planning and trust, corporate advisory and private wealth management.

Conclusion

What began 200 years ago as a merchant bank with offices in Baltimore, Philadelphia and Liverpool is now a global firm with 18 offices around the world and about 6,000 employees. BBH has had the privilege of guiding its firm and clients through the best of times as well as the worst of times.

Financial markets and the wealth management industry continue to evolve, presenting both risk and opportunity. And yet, the more things change, the more they stay the same. A quiet and confident focus on doing the right thing for clients, with a wary eye on risk, has defined our first two centuries as it will the next two and beyond.

Past returns do not guarantee future results.

The S&P 500 is an unmanaged weighted index of 500 stocks providing a broad indicator of price movements. The index is not available for direct investment.