

As a Partner at a Private Equity Firm, Are You Prepared?

Your financial situation is unique as a Partner in a private equity firm. You are accumulating wealth rapidly and at a young age, which comes with obvious benefits, but you will also face challenges and additional responsibilities. As the stakes get higher, the weight of properly planning for the future may become heavier.

This paper was not written to package information that can be easily found online. Instead, we aim to pass on what we have learned from experience and give advice on how to move forward confidently.

What Makes You Unique?

As a Partner at a private equity firm, you may be among the top one percent of earners in the United States.

You are proficient in all aspects of finance. You have daily access to other overachievers inside and outside your firm. Due to your intimate relationship with your portfolio companies, your unique lens of the economy may give you an edge by allowing you to recognize trends forming long before the public and invest opportunistically in your companies.

In addition, you participate meaningfully in your company's private offerings and possibly own a portion of carried interest. Since your industry is a tight community, you are most likely presented with early-stage opportunities that other investors hear about only after the investment exceeds expectations.

The result of the factors above is that as a Partner, you have accumulated or will accumulate wealth on a much larger scale and steeper curve than most people (see chart). To achieve maximum earning potential, you may be handcuffed to your employer for better or worse, which can enhance your upside while imposing additional risks and potential stress on your situation.

This wealth can give you many freedoms. With the pace at which you have been running all your career, the freedom to retire, or at least slow down, at a relatively young age could be a consideration.

Capital calls, fund distributions, and taxes must be estimated and modeled to discover any timing mismatches. For example, Fund I is nearly fully invested in its fifth year, generating significant phantom income. Meanwhile, Fund II launched and began calling capital, but Fund I hasn't made a distribution yet. The situation gets even more complicated when you include other cash flow needs for personal reasons.

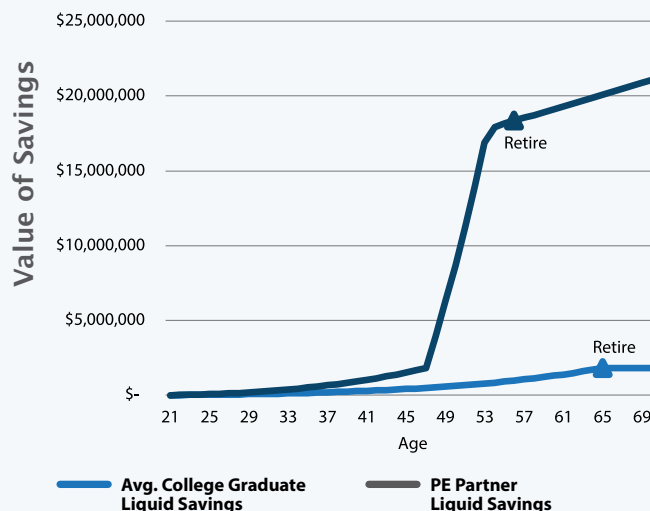
Planning is required to optimize cash flows. Your greatest resource, time, is becoming more scarce as you work hard to create more value for your portfolio companies and, somehow, find time for family and personal interests. This may lead you to a feeling of "things are fine," but as an overachiever, you know "fine" is not good enough.

What should you be doing now?

At this stage in your career, you are most likely focused on accumulating wealth as quickly as possible.

With more wealth comes additional complications. Now more than ever, it is pivotal to control what you can. So, what can you control right now? In addition to the low-hanging fruit – like investing in tax-free over taxable bonds, maxing

Savings Accumulation of an Average College Graduate vs. a Private Equity Partner



Note: This chart is for illustrative purposes only and does not represent actual experiences. It is based on realistic compensation, contribution rate, and growth rate assumptions to demonstrate the potential wealth accumulation difference between an average college graduate and a private equity partner, showing the rapid wealth growth in the mid to later years of a PE partner's career coupled with an earlier retirement.

According to Vanguard, personalized indexing can increase after-tax returns by 1 percent to 2 percent annually.

out your 401(k) contributions, and avoiding short-term capital gains,¹ – you should focus on mitigating future taxes, systematizing savings, and using debt appropriately.

As a Partner, you have substantial gains stemming from private investments, and because of your income level, you are taxed in a high bracket. Therefore, tax-loss harvesting (TLH), a decades-old strategy that capitalizes on market downturns to realize losses to offset future gains, should be your priority.

Thanks to recent technological improvements, TLH can be done on a much more frequent, inexpensive, and customizable basis. One sophisticated approach that can add tremendous value when executed properly is personalized indexing, where you own a few hundred individual stocks that track a custom benchmark.

Tax loss opportunities exist throughout the year, as history shows that a large portion of the stocks in the S&P 500 will trade at a loss at some point during the year. This even occurs in positive years. According to Vanguard, personalized indexing can increase after-tax returns by 1 percent to 2 percent annually.²

¹ Positions held less than 12 months and sold for a gain are taxed at ordinary income rates.

² <https://advisors.vanguard.com/insights/article/amp-up-tax-loss-harvesting-with-direct-indexing.html>

Maintaining cash flow is important. Capital calls, distributions, and the potential for unexpected tax payments may cause liquidity issues and forced sales. These conditions may make it difficult to save for long-term goals. To increase your chances of success, you should follow a written plan to contribute to your non-retirement accounts systematically. Adhering to a plan ensures near-term cash needs and long-term goals like retirement, college funding, philanthropy, vacation homes, etc., are adequately funded.

Debt, when used appropriately, can enhance wealth by working as a force multiplier. Take the carry trade, for example. Holding a low-interest loan, like a mortgage, and pairing it with a higher-yielding fixed-income investment is a risk-free way to achieve a positive arbitrage. In this example, paying down a mortgage with a bonus may give immediate satisfaction but would be costly in the long run. Also, using debt as a bridge loan for things like capital calls and tax payments can be advantageous to selling stocks and realizing gains (taxes!).

This also preserves the compounding effect of equities. While debt can cause some anxiety, money is left on the table when misunderstood and ignored. This is not the behavior of an overachiever.

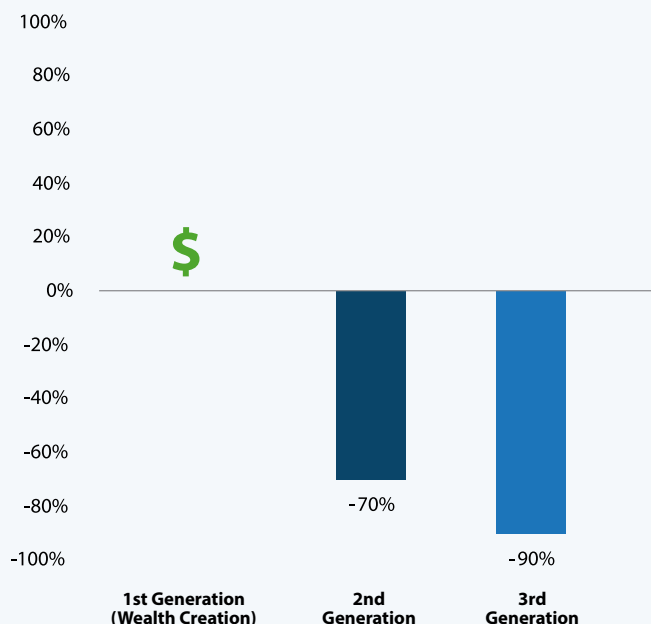
As you achieve significant wealth, your focus may shift from immediate to multi-generational planning.

According to research by the Williams Group, 70 percent of wealthy families lose their wealth by the second generation and 90 percent by the third.³ Considerable thought must be given, even at a young age, to how you pass on your assets. Some decisions will be irreversible.

Whether the aim is to minimize taxes, give to a loved one or charitable cause, or a combination of both, maintaining a balance between control, flexibility, and financial prudence is like walking on a tightrope. One misstep could cause your after-tax estate to fall well below your desired goal.

The first step is ensuring your estate plan is current. It is estimated that between 50 and 60 percent of individuals with a net worth greater than \$5 million do not have a will. You have worked hard to be in this position and do not want to be a part of that 50-to-60 percent group. Intentions must be well thought out, and wills and directives must be executed. Only then should you consider making irrevocable gifts. If reducing your estate and/or increasing another's estate is important to you, one common, low-risk technique is making gifts today utilizing the annual gift tax exclusion.⁴

Longevity of Generational Wealth



The second step is deciding if gifting substantial assets should be part of your overall plan. If so, determining the appropriate timing is also vital (i.e., giving with a warm or cold hand). You understand the power of compounding and the drag from taxes. Passing along assets today that would otherwise be subject to estate taxes can profoundly impact how much you leave to future generations.

Finally, the last step is determining whether gifting or selling some of your carried interest to future generations is desirable and, if so, whether it is possible. An attorney can handle the mechanics of a transaction but arriving at your wishes and committing to them is your responsibility.

Once estate decisions are made, protecting your assets is necessary to ensure your estate planning and philanthropic goals are met.

Your current assets and future earnings potential are both at risk. You've most likely become accustomed to a very comfortable lifestyle, and your current earnings may be necessary to continue "feeding the machine" for years. While most people do not like considering and paying for insurance, peace of mind and financial support are usually worth the cost when needed. Insurance to replace income upon death or disability should, at a minimum, be priced out. On the liability side, families with significant assets could be targets. To cover extreme cases of catastrophic liability claims, umbrella insurance policies, which are inexpensive and easy to obtain, should be considered.

³The Williams Group cites this statistic in multiple publications, including the book *Bridging Generations: Transitioning Family Wealth and Values for a Sustainable Legacy*, which is based on research on over 2,500 wealthy families.

⁴The annual gift tax exclusion is an amount set by the IRS each year that can be given to any number of individuals without being counted against one's lifetime gift tax exclusion.

With your estate plan finalized and all risk management gaps filled, it is natural to start thinking about philanthropy for economic benefit and personal satisfaction. At this time, you may be receiving requests from local charities, non-profit boards on which you sit, and even local schools for donations. While using cash is easy, there are more tax-efficient ways to give to these organizations.

As your balance sheet grows and your estate plan evolves, charitable planning may become more prominent in your thoughts and discussions with others. While there are many techniques one can implement when it comes to giving to charity, the most important thing is understanding exactly what you are trying to accomplish.

For example, is a significant one-time gift now or at death the way to go? Or is a smaller annual gift in perpetuity better? Is it appropriate to include a formal bequest in your will, or should you give yourself flexibility by merely verbalizing your intention? Because there are many ways to implement a charitable giving program, it is most important to plan with a clear understanding of your goal.

How should you think about your investments?

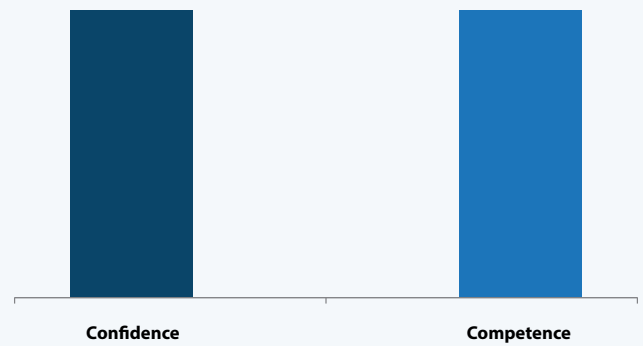
Odds are that the most lucrative investment you will ever have is the ownership in your funds. The combination of both your stake and carried interest provides a unique opportunity for wealth creation. However, as distributions are paid out, building a liquid portfolio of stocks, bonds, and alternative investments is sensible, as it diversifies some of the concentrated risks in your company.

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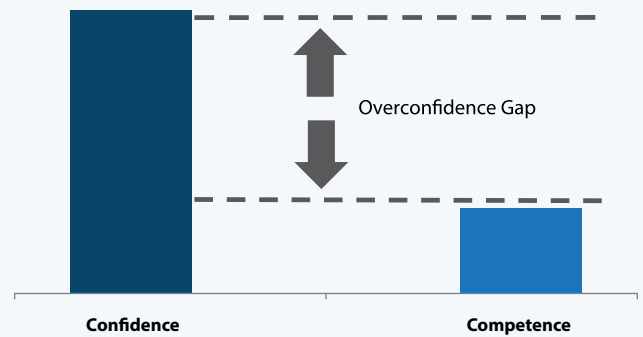
Even the strongest savers aren't immune from the risks of a poorly managed portfolio. Reacting to market news and making emotional investment decisions can be pitfalls for otherwise intelligent investors. As a highly experienced financial professional, you may believe you can beat the public markets consistently. In behavioral finance, this is called overconfidence bias and can lead sophisticated investors to take excessive risks that erode returns. History continues to show us that beating the market after fees and taxes is a very challenging feat. Whether one outperforms the market or not, even the best portfolio managers should not ignore the power of systematically adding to their portfolios. Combining a disciplined savings plan and an optimally managed portfolio separates the hyper-successful from the rest.

There are two schools of thought when allocating capital to stocks and bonds: Tactical Asset Allocation and Strategic Asset Allocation.

PE Partner in PE Industry



PE Partner in Wealth Management



Tactical Asset Allocation is adjusting a portfolio based on short-term market movements or economic forecasts. This approach aims to exploit market inefficiencies and beat the market. Unknowingly, many people fall into this category when they manipulate their portfolios based on economic and geopolitical news. Research has repeatedly shown that such moves are counterproductive over time.

Strategic Asset Allocation sets a target based on the investor's unique situation and then periodically rebalances the portfolio through all market conditions. This requires deliberate portfolio construction, discipline, and an investor's ability to focus on a longer time horizon. Strategic asset allocation may seem too simple since you have experience in more intricate investments. While this strategy may imply simply buying and holding an index, it is quite nuanced when done properly. For example, as previously mentioned, personalized indexing is one way to enhance after-tax returns. Additionally, the customizability of a personalized index allows investors to tilt their portfolio towards evidence-based drivers of higher expected returns, such as value, profitability, momentum, low volatility, and small size. The same tailored approach should be applied to your fixed-income portfolio.

As someone who has experienced high returns in private investments, investing in the public markets may prove difficult. However, having a portion of your assets in a

well-constructed portfolio of publicly traded securities can provide acceptable returns and liquidity. This diversification is pivotal to growing and protecting your wealth.

Who can help?

A miss in tax management, estate planning, or investment management could be disastrous.

Building a strong team of trusted advisors is essential. Working with a proficient CPA is needed to sort through your numerous K-1s, ensure no deduction is missed, file in all necessary states, and make tax projections. At your tax rate, every dollar counts.

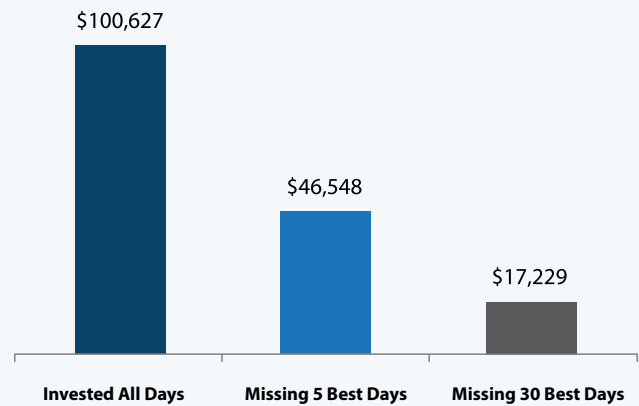
On the estate planning side, it is necessary to have a competent attorney who can understand your intentions, communicate clearly, and accurately draft the needed documentation. **The wealth advisor ties all of this together.** In addition to investment management and financial planning, the wealth manager leads the team of professionals and continuously collaborates with them on your behalf.

You have the intellect to construct a portfolio of stocks, mutual funds, and ETFs, but true wealth management isn't just assembling a basket of securities. Behavioral finance and removing the emotion from investment decisions are also huge components. One popular study showing the power of staying fully invested in the market is very compelling. Over the 30 years ending January 31, 2024, the S&P 500 returned eight percent annually. Missing the 10 best days over that period reduces the annualized return to 5.3 percent, and missing the 30 best days reduces the return to 1.8 percent.⁵ Of course, missing the 30 best days is unlikely. Research shows that the top-performing days often follow a sharp selloff and that just a few days drive much of the index's annual gain.

Helping investors stick to the plan is critical. As with top-performing private fund managers, the right wealth advisor adds tremendous value. Vanguard's research shows that advisors can add up to 3 percent of value per year.⁶

Hypothetical growth of \$10,000 invested in the S&P 500

February 1, 1994 through January 31, 2024



Building a strong team of trusted advisors is essential.

As you accumulate wealth, before hiring a wealth manager, you should ask yourself the following questions:

- Do you enjoy researching and investing outside your private funds?
- Because your situation is not a set-it-and-forget-it exercise, is ongoing financial planning something you look forward to doing?
- Do you like spending your free time staying current on the tax code to capitalize on opportunities?

If you answered yes to the above questions, you may be one of the few who can manage your wealth properly. If not, [Ullmann Wealth Partners](#) has an experienced group that works specifically with individuals like you: hardworking, time-crunched professionals with a net worth greater than \$5 million.

⁵ Source: Wells Fargo- The perils of trying to time volatile markets

⁶ Source: Vanguard: Investment Advisory Research Center – July 2022 – Putting a value on your value: Quantifying Vanguard's Advisor's Alpha®

About Us

[Ullmann Wealth Partners](#) is a leading wealth management firm dedicated to helping high-net-worth individuals and families achieve their financial goals. For over 20 years, the firm has delivered advice and personalized solutions in investment management and has provided advanced planning by working closely with the client and their other trusted advisors.



Jack Gunn, CFP®

jgunn@ullmannwealthpartners.com

[Jack Gunn](#) is a Director and Wealth Advisor at Ullmann Wealth Partners. With nearly two decades of experience advising Ultra-High-Net-Worth families, he focuses on helping founders of private companies and partners of firms in demanding careers.



Mclain Johnson, CFP®

mjohnson@ullmannwealthpartners.com

[Mclain Johnson](#) is a Certified Financial Planner at Ullmann Wealth Partners. He has worked on hundreds of financial plans for executives, business owners, and retirees and advises many of the firm's clients with complex financial situations.