BERNSTEIN

ELECTION TIME

Which Are the Best Candidates...for Wealth Transfer?

At any given time, the capital markets generally create two broad categories of assets: "leaders" and "laggards." But recent market turmoil appears to have spurred a race to the bottom. There is one bright spot, though. With valuations widely depressed, plenty of good contestants for substantial future appreciation have emerged. Which of these might make truly spectacular wealth transfer candidates? Those that are likeliest to thrive when recovery eventually occurs. With that in mind, we have scoured the investment universe to find the stock, bond, and alternative investment strategies with the greatest upside potential from here. In our view, these represent the winning candidates for wealth transfer today.

HISTORY MAY NOT REPEAT ITSELF...

In March 2009, the US economic outlook seemed bleak: unemployment hovered at 8.5%; US GDP had contracted by 8.4% the previous quarter; and the S&P 500 had tumbled 57% from its peak. In response, 10-year Treasury rates fell to near all-time lows. At the time, uncertainty sank markets. Yet, savvy investors saw low valuations as an opportunity. Some wealthy families took advantage of prevailing conditions to engage in wealth transfer planning. The Section 7520 rate—the return rate that a grantor retained annuity trust (GRAT) and certain other wealth transfer strategies must exceed in order to achieve success—stood at 2.4%. Wealthy families who seized the day adeptly shifted assets from their balance sheets to a range of vehicles for the benefit of generations to come. And all it took was the ability to see through the haze to the silver lining underneath: a rare combination of low valuations and low rates.

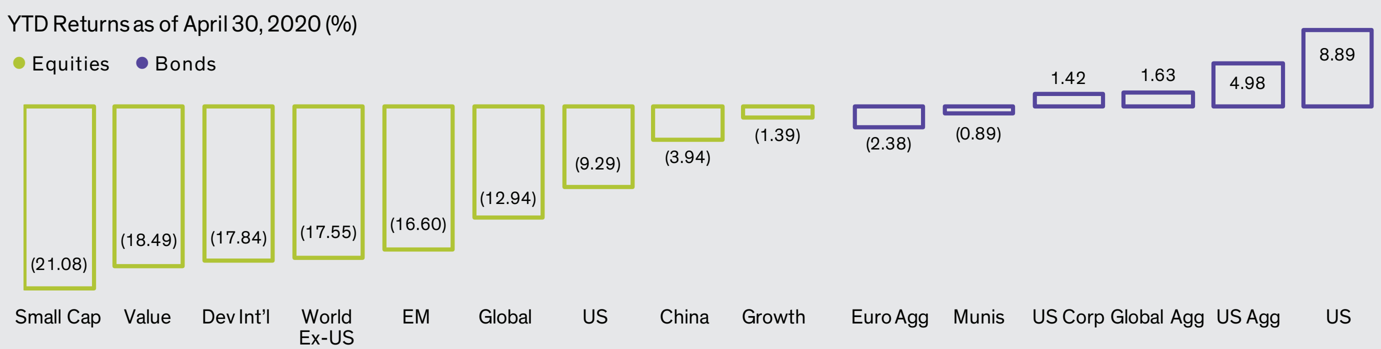
...BUT IT RHYMES

Today's crisis contains echoes of that earlier era. By the end of April, US unemployment had surged to over 15%; first quarter US GDP had declined by 4.8%; and the S&P 500 had fallen 12% from record highs. The biggest difference? Interest rates are much lower today: in May 2020, that same Section 7520 hurdle rests at just 0.8%. Yet as in March 2009, valuations remain depressed across a wide range of asset classes, offering plenty of compelling candidates for substantial future appreciation. But which assets and asset classes might prove truly spectacular candidates for wealth transfer?

SIZING UP THE POTENTIAL

Between these two factors—market valuation and interest rates—valuation remains more important, by far. This holds true whether the transfer strategy of choice is a gift, GRAT, or installment sale to an irrevocable ("intentionally defective") grantor trust (IGT). But it's not as simple as selecting the lowest common denominator. Other factors play a role, too. For instance, which low valuation assets seem likeliest to survive the current crisis, and thrive once recovery eventually takes hold? We have searched the investment universe and identified certain asset classes and services—spanning stocks, bonds, and alternatives—that offer the greatest growth potential. These, arguably, represent today's best wealth transfer candidates in our view *(Display 1)*.

DISPLAY 1: BROADLY DEPRESSED VALUATIONS PROVIDE APPRECIATION POTENTIAL



Past performance is not necessarily indicative of future results. There is no guarantee that any estimates or forecasts will be realized.
Equities are represented as follows: Small Cap—Russell 2000 Index, Value—Russell 1000 Value Index, EM—MSCI Emerging Markets Index, World Ex-US—MSCI ACWI ex US, Dev Int'l—MSCI EAFE Index, Global—MSCI ACWI, US—S&P 500 Index, Growth—Russell 1000 Growth Index, China—MSCI China All Shares Index. Bonds are represented as follows: US Corp—Bloomberg Barclays US Corporate Bond Index, Euro Agg—Bloomberg Barclays Euro Aggregate, Munis—Bloomberg Barclays 1-10 Yr Municipal Bond Index, Global Agg—Bloomberg Barclays Global Aggregate, US Agg—Bloomberg Barclays US Aggregate Index, US Treasuries—Bloomberg Barclays US Treasury.
Source: Russell, S&P, Bloomberg Barclays, MSCI, AB

FOCUS ON LIQUID ASSETS FIRST

For most clients who have both the capacity and desire to transfer wealth, the time to act is now, at current valuations. Don't postpone wealth transfer initiatives involving marketable securities solely to capture a further dip in interest rates.

Why? In the current environment, an illiquid asset—like an ownership stake in a closely held business—may be substantially discounted from its ultimate liquidation value. And such discounts are likely to persist for the foreseeable future. On the other hand, readily marketable assets such as publicly traded stocks tend to fluctuate in value due to volatility. The potential for dramatic swings heightens the urgency surrounding a sale or other wealth transfer strategy.

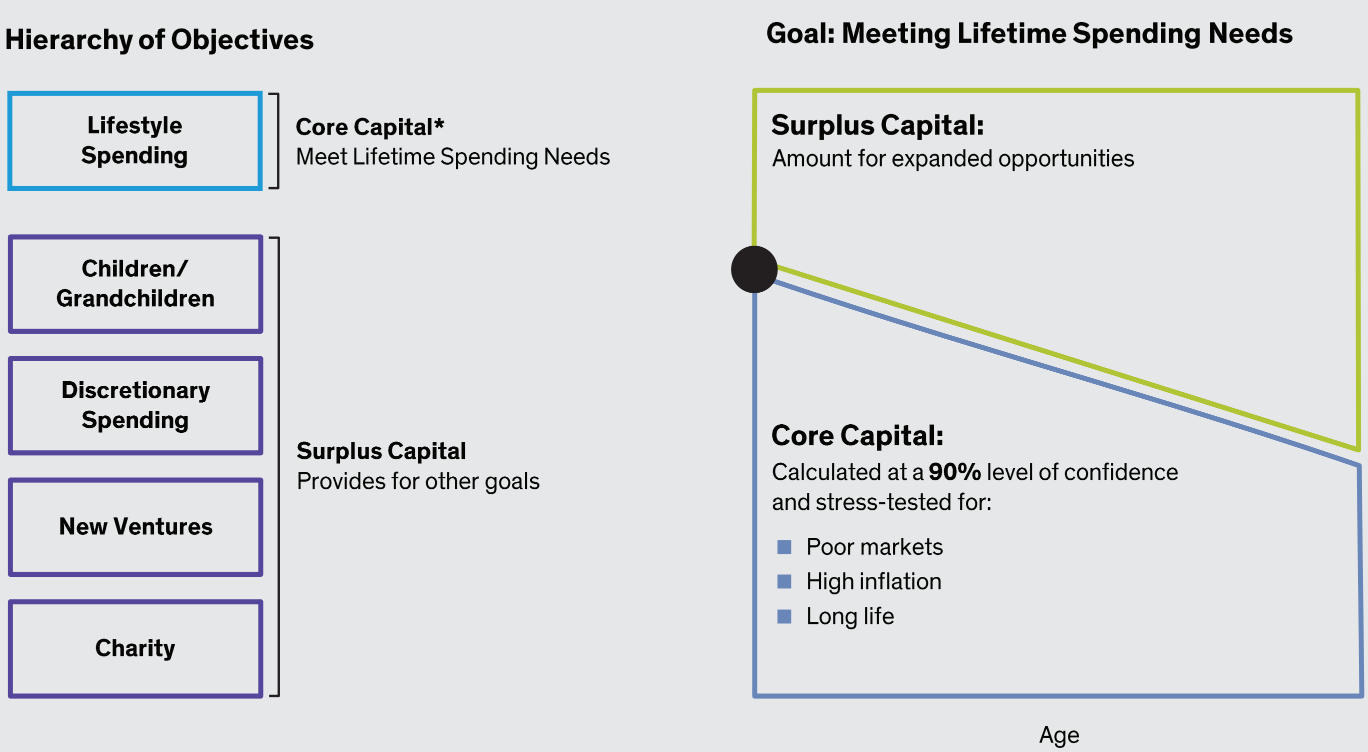
Given the potential for volatility, transferring to a grantor trust may prove advisable. This move gives the grantor an opportunity to "swap" assets with the greatest upside potential into the trust—without incurring income tax consequences—in exchange for less "growthy" assets, and to change that mix from time to time as circumstances warrant.

CAPACITY TO GIVE

When sizing a potential wealth transfer strategy, we advise clients to first set aside an amount of wealth that will support lifetime spending needs, indexed for inflation, with a very high degree of confidence. We call this amount "core capital." To calculate core capital, we start with a client's desired spending level and the amount of investment risk she feels comfortable assuming. Then, using our proprietary Wealth Forecasting System, we solve for the amount of wealth that will sustain inflation-adjusted spending with high confidence even if future market returns are poor, future inflation exceeds expectations, or the client lives beyond actuarial life expectancy.

Over time, the amount of core capital needed declines. That's because as people age, the required pool of wealth must support fewer years of additional spending. Any excess above the core amount may be considered "surplus capital"—an amount that clients can give away, safely and irrevocably, without impacting lifestyle *(Display 2)*.

DISPLAY 2: CORE AND SURPLUS CAPITAL



*The amount needed to support your lifestyle as long as you live.

Source: AB

WEALTH TRANSFER STRATEGIES

Below we outline strategies to consider for those families bold enough to act:

- For diversified, marketable stock holdings—and concentrated, single-stock positions in particular—a series of short-term, "rolling" GRATs tend to offer the greatest prospects for success.
- For assets other than marketable securities—including alternative investments, real estate, closely held business interests, and other illiquid holdings—an installment sale to an IGT will likely prove the better choice. Consider this: In exchange for the assets sold, the seller receives a promissory note, which usually bears interest at the applicable federal rate (AFR) in effect for the month of the sale. The AFRs for May 2020 hover at or near historic lows, ranging from 0.25% to 1.15% per year, depending upon the term of the note.
- Think of this promissory note as an option to complete a gift. Such an option could prove handy depending on future tax changes. For instance, Democrats have proposed lowering the gift and estate tax exclusion from its current level, $11.58 million, to a fraction of that amount, effective as early as January 1, 2021. If the Democrats sweep the White House, House, and Senate in November, the holder of a promissory note would have roughly eight weeks to forgive the debt (in whole or in part), complete the gift, and use some or all of their current, elevated exclusion amount.
- With interest rates sitting at such low levels, most clients lack the impetus to commit to a large gift today. In contrast, a sale or loan in the current environment provides an attractive arbitrage opportunity (i.e., the expected return on investment greatly exceeds the cost of borrowing), as well as an option to make a future gift—by forgiving the debt with a mere stroke of a pen.

DISPLAY 3: THE BALLOT: TOP CANDIDATES FOR WEALTH TRANSFER

Asset Category or Investment Service	Description	Valuation Required	Installment Sale	Short-Term, Rolling GRATs	Long-Term GRAT	Outright Gift
Concentrated, publicly traded single stock	Stock in a single company that makes up a substantial part of an investor's portfolio.	No, daily market value		X		
Diversified portfolio, publicly traded stocks	A portfolio of companies of different market capitalization, sectors, and geographies.	No, daily market value	X	X		X
High Yield Fixed Income	Invests primarily in non-investment grade corporate debt.	No, daily market value	X	X		X
Asset-backed Fixed Income	Capitalizes on opportunities in securitized assets.	No, daily or monthly market value	X	X		X
Sector-focused Equity Fund	Seeks to capitalize on secular opportunities within a specific sector (public or private equity).	No, daily market value (public); monthly or quarterly market value (private)	X	Maybe, not appropriate for private equity calling capital		X
Real Estate (directly held or in a partnership)	Real estate portfolios focus on "distressed" opportunities during the early stages of a slow and uneven recovery by identifying mispriced assets, restructuring, recapitalizing, and stabilizing.	Yes, if closely held Real estate partnerships typically value monthly or quarterly				
High cash flow					X	
Low cash flow			X			
No cash flow			Pair installment sale of real estate with short-term, rolling GRATs funded with marketable stocks			X
Closely held business interest	A business entity whose shares are held by a small number of stockholders, often within just one family. Current valuations of such interests are extraordinarily low due to economic uncertainties.	Yes				
High cash flow					X	
Low cash flow			X			
No cash flow			Pair installment sale of business interest with short-term, rolling GRATs funded with marketable stocks			X

FUTURE WEALTH BUILDING BEGINS NOW

Now is the ideal moment to broach wealth transfer planning with clients, especially for assets and asset classes that offer extraordinary prospects for future growth. Bernstein's Wealth Forecasting System can help investors understand that these strategies remain affordable, despite the current market turmoil. We welcome the opportunity to partner with you and help clients achieve amazing results.

The Bernstein Wealth Forecasting System℠ uses a Monte Carlo model that simulates 10,000 plausible paths of return for each asset class and inflation and produces a probability distribution of outcomes. The model does not draw randomly from a set of historical returns to produce estimates for the future. Instead, the forecasts: (1) are based on the building blocks of asset returns, such as inflation, yields, yield spreads, stock earnings, and price multiples; (2) incorporate the linkages that exist among the returns of various asset classes; (3) take into account current market conditions at the beginning of the analysis; and (4) factor in a reasonable degree of randomness and unpredictability. Moreover, actual future results may not meet Bernstein's estimates of the range of market returns, as these results are subject to a variety of economic, market, and other variables. Accordingly, the analysis should not be construed as a promise of actual future results, the actual range of future results, or the actual probability that these results will be realized.

AllianceBernstein L.P. or its affiliates makes no representations or warranties concerning the accuracy of any data. There is no guarantee that any projection, forecast or opinion in this material will be realized. Past performance does not guarantee future results. The views expressed here may change at any time after the date of this flyer. This flyer is for informational purposes only and does not constitute investment advice. AllianceBernstein L.P. does not provide tax, legal or accounting advice. It does not take an investor's personal investment objectives or financial situation into account; investors should discuss their individual circumstances with appropriate professionals before making any decisions. This information should not be construed as sales or marketing material or an offer or solicitation for the purchase or sale of any financial instrument, product or service sponsored by AllianceBernstein or its affiliates.

BER-1817-0520
Bernstein.com