# Inside View: A Conversation with Your Private Wealth Management Leaders

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**TRANSCRIPT**

**SPEAKERS:**

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Views expressed are as of 5/6/20 based on the information available at that time and may change based on market or other conditions. Please read the last two pages of this transcript for important additional information.

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**Roger Hobby:** Good morning and good afternoon. My name is Roger Hobby. I'm the head of Fidelity's Private Wealth Management Business. And I welcome you here today to an ongoing discussion that we've been having with our clients about some of the issues associated with our market, the economy, as well as some of the disruption from the virus.

We're going to be joined today by Nick Yoo and Michelle Caffrey who are two of our experts. This is a presentation specifically for private wealth management and the Fidelity Wealth Services offering within our particular group. Michelle and Nick are two experts. Nick is one of our experts around investment management. Nick deals directly with clients. Many of you have probably met Nick or his team. He manages the team that helps our clients manage their individual portfolios and he is one of the people that we turn to to lead the organization around how to position and how to deal with some of these short-term as well as some of the long-term opportunities and challenges in the market. Michelle is part of our advanced planning team. She deals with our most complex clients as it relates to financial planning and estate planning. Today we're going to have a conversation with them today. I'm going to be operating as the moderator. And why don't we get the ball started?

Nick, we've never seen anything like this before. We've had unemployment skyrocket. We've got interest rates down. We've got a tumultuous market, up, down, sideways, commodities, our oil prices, never seen anything like this, and the background of a pandemic. What are, from your perspective, some of the short-term and some of the long-term opportunities and challenges that clients should be thinking about and that we can help them with as it relates to investing and investing their assets?

**Nicholas Yoo:** Sure. You know, thanks, Roger, for inviting me to the conversation today. I know with our investment team, it's really important for us to connect directly with our clients as much as possible. We do that a lot of one-on-one work with our clients, but these events are great as well. We hope now to continue these. And just to remind folks, my team, as Roger mentioned, oversees the managed portfolios, that's the full asset allocation managed portfolios that we do the day-to-day implementation and trading on and asset allocation with. These can come in really two kind of solutions. You can have a single account solution where we're building a full diversified asset allocation within a single account and we also have what we call our multi-account solution where we can take multiple accounts, like your joint taxable accounts or trust accounts and your IRAs and retirement accounts, and combine them together and create a coordinated diversified asset allocation across those. That brings a lot of other benefits. We'll talk about those two today together.

But to answer your question, Roger, you're right, this is a totally unprecedented event. You really can't predict these things as they happen. But the reality of what happens behind the scenes with us is we're actually planning for these things, these type of outlier events, recessionary type events, all the time. Even in good markets, we're doing scenario planning where we're using a disciplined investment process. And when we refer to that discipline, it's really let's get the resources of Fidelity, our team of economists, our portfolio of managers, our analysts, let's get all of their inputs, and start scenario planning about what would happen in a market crunch like this, 10% down, 20% down, 30% down. And the opportunities, while these are unsettling times, the opportunities are in repositioning the portfolio, rebalancing the portfolio, and also taking advantage of tax management during these times. So there are opportunities, even though it's a scary time sometimes. The important part is to have a playbook before you get there, because when these things happen, they happen so fast, and have some variation of a playbook you can put together really quickly to implement a plan.

**ROGER:** Yeah. Well, I'm going to dig in on some of those scenario planning that you were thinking about. We can hear more about them in a second. But let's put it to you, Michelle. This market represents an opportunity for us to be thinking about our financial and estate plan differently, probably really more important now than ever to have a plan in place. But would you talk a little bit about some of the short-term and the long-term opportunities and challenges from a planning perspective?

**Michelle Caffrey:** Yeah. Sure, Roger. Thanks for having me. And that's certainly a great question. But I think before I get into the opportunities, I just want to say that, you know, what has transpired over the past several months really drives home the importance of having a financial plan to allow us to personalize and make shifts within the investment portfolio as needed. And when thinking of the importance of a plan, a few things come to mind. First, you know, clients who have a financial plan in place are or should be in the best position to achieve their objectives. By working together, we understand asset composition, whether that's taxable, non-taxable, or tax-deferred types of assets, ownership, income and spending levels, asset diversification, risk tolerance, time horizon, estate implications, just to name a few. What I would say is likely most important, right, would be the client's goals, whether that be retirement, wealth transfer, or something else. And by having a working understanding of all of these items, this allows us to apply our best thinking to the overall financial picture. And next would be that clients with a well-thought-out plan are in a better position to stay the course, right, to understand how an overall plan may be impacted in a time of market volatility to allow us as planners to revisit our analyses, to stress test plans given portfolio declines, and changes in income and spending levels, and hopefully provide peace of mind that the existing plan still holds true. And lastly, I would say that clients with a plan are better suited to take advantage of opportunities in a time of market volatility. So through creating plans and working together, we gain understanding of a client's goals and wishes and the components of their financial picture, allowing us to better align our ideas in a timely fashion. So before getting into kind of what our opportunities are, I just wanted to kind of level-set and say these are the important reasons as to why. But, you know, given the low interest rates, there are certainly strategies that we're talking to a lot of our clients about, and I can get into that a little bit more now or if you wanted to wait.

**ROGER:** Well, we will. But let's go back to the point that you were making because it was interesting. Your plan is going to be impacted by your income. Your plan is going to be impacted by your expenses. In this kind of an environment, both of those things, for a number of people, have been impacted relative to interest rates going down. Some people have had jobs or people that they know that they have to care for or take care of have been impacted either from an income or from an expense point of view. How does someone think about those changes as it relates to their plan?

**MICHELLE:** I would think of, you know, looking at the plans that we have in place, looking how the income has been impacted possibly, or increased spending, and saying, okay, what does the success of the plan look like given all of these changes. Do these changes require a change in the overall asset allocation? I would say likely for the long-term plans, there probably aren't changes needed, right, because these were well-thought-out positions that we went into understanding the client's goals. But, you know, the tools that we use and the understanding of the clients that we have allows us to stress test the plans and hopefully provide that peace of mind that even in these hard times that the plans are still holding true.

**ROGER:** Yeah. Okay. Nick, let me put it back to you. I know you don't have a crystal ball, but it sounds like—and not surprising—that your team and the Fidelity Investment Management team has been spending time previous to this thinking about these catastrophic type events. Obviously, we didn't plan on a pandemic in any way, shape, or form. But a 20%-30% market downturn, interest rates being as low, the commodities being as low, what does that do to a capital markets forecast? What does that do to simulations that you would be running as it relates to not only thinking about the opportunities in the short term but over a longer period of time? How did we react when it happened and what should we be doing? How do clients take advantage of it?

**NICHOLAS:** Sure. You know, a couple things. I think part of always looking at where we are right now is just as important as thinking about where we might be in the future with the business cycle with events that are happening. Even last summer, for example, we certainly felt as though we were in the later stages of a business cycle, and we were already derisking at that point. We didn't know COVID-19 was coming. That wasn't, as you said, wasn't even in anyone's vocabulary yet. But derisking early on when we did think—see global growth slowing down certainly helped as we did enter this period. And then as you get into this event that's so rapid and so unpredicted, right now you're still kind of really at the height of uncertainty. All of these things are absolutely changing. It's a different environment. It will impact how we see the future and how business is done in the future. I think things—there will be some things that will be different forever. But at the height of uncertainty, that's the most important time to be very, very risk controlled and really be careful about all of your positioning and any kind of risk positioning and stay very diversified. At the height of that uncertainty, we have to watch for a couple things. First, obviously, what is the duration and magnitude of this health crisis? We have to see how that's going to play out because that's going to help us make a better assessment about economic damage. At this point, we certainly feel as though we're in an onset recession. That means go to our recessionary playbook in the portfolios. That means modest underrated equities, more of a risk off type of positioning, more of a quality tilt to our positioning, and building into the portfolio other downside protection type liquid positions like treasuries and cash. And as we think about that in a multi-account structure where we can have taxable accounts and retirement accounts working together, there's opportunities we can take advantage of right away there, which is use the IRAs to quickly derisk the portfolio because you can do it without a tax impact. And at the same time, if you're going to be positioning some treasuries into the portfolio, try to start positioning some of those in the IRAs to protect it against the tax distributions or interest on those, and then begin to tilt your taxable portfolio towards U.S. equity, large cap needs, for example, where we can find really cost-efficient and tax-efficient vehicles to continue to keep the overall picture tax-efficient. So a lot of repositioning and thinking about how to position the portfolios not only for dealing with the now but also having liquid positions where when things do start to show improvement and things do start to get a little clearer.

**ROGER:** I'm going to put it back to you, Michelle. Let's go back to the question that we talked about before. Short-term, if I'm a client, this is an unsettling market, but it also is a market environment that gives us the opportunity to take advantage of certain capabilities and to use certain tools. I know you and I have spoken about that. Would you mind digging in a little bit about some of the specifics around how to take advantage of this type of an opportunity?

**MICHELLE:** Yeah, absolutely. Given where interest rates are now, there are two strategies that we're talking to a lot of our families about. The first is intra-family loans*. Right? And intra-family loans allow clients to loan funds to family members at a reduced rate than they would get from commercial lenders to keep the financing within the family. We often see this used to help family members invest in a business, to buy real estate, or pay down high interest debt. Now the mid-term AFR, the applicable federal rate, and this does change monthly, for May of 2020 is 0.58%.

**ROGER:** And mid-term, tell us what is mid-term?

**MICHELLE:** Mid-term is up to nine years, so three to nine years.

**ROGER:** Okay. And the shorter term is under three years, and the other one is greater than nine years.

**MICHELLE:** Exactly. And the long-term rate for May is 1.15%. So, certainly, you know, unprecedented—

**ROGER:** Put that in perspective for our clients. Where is that relative to your career, your experience, and those rates for that long-term type of an event. Have you ever seen that before?

**MICHELLE:** I've never seen that before. No. I certainly have not seen that before, so this is a great opportunity to take advantage of those low interest rates. Right? It could be, as I mentioned, helping, you know, a family member buy something, but it could also be an estate planning technique. So pairing this type of loan with a trust say that's outside of a client's taxable estate can help to transfer appreciation in excess of the applicable federal rate free of gift and estate taxes. Now it's important, of course, that the loan is implemented properly, so not to be viewed by the IRS as a gift which could have unintended estate tax consequences. So implications from an income, gift, and estate tax perspective should all be reviewed prior to going into, you know, a note like this. But another strategy that we've been talking to a lot of our families about are GRATs, or grantor retained annuity trusts. And these are trusts created for a period of time whereby the grantor or the donor or the person who created the trust gives up control of trust assets for the term while receiving regular annuity payments comprised of interest and principle. And at the end of the trust term, the growth or the earnings in excess of the hurdle rate may pass to heirs free of gift and estate taxes. And the hurdle rate that I reference here is the 75/20 rate which was 0.8% in May of 2020. So the growth of the earnings in excess of the 75/20 rate at the end of the GRAT term can either pass outright or in trust for the trust beneficiaries. Right? So the goal of the GRAT strategy is to freeze a portion of the estate's value today, allowing future appreciation on those assets to pass free of estate tax.

**ROGER:** Do you have a window? Do you have a window you recommend, the time that a GRAT should be, or is there a staggered number of GRATs that you have to take advantage of? Do you have a recommendation?

**MICHELLE:** I would say we typically see the GRATs being for shorter terms, maybe two or three years. But you can—they could roll into—you know, you could have one GRAT that just rolls into another and the assets keep rolling into another new GRAT. And the benefit of doing the shorter time period is if the GRAT doesn't work out, you're not stuck with those assets being in that GRAT. But the benefit of doing a longer period is you're locking in that lower rate, right, that 0.8% that I referenced before. And I just want to mention that neither one of these strategies, of course, comes without risk or potential drawbacks, and not all of the strategies will apply to all of our clients. Right? So it's always important to work with us and to work with your tax advisors and legal advisors to be sure that there is proper documentation and execution of these strategies.

**ROGER:** Yeah. That's a very well—very well said. But the point that I'm making, the point that you're making that I just want to reiterate is low interest rates, from an income perspective, kind of stink. Low interest rates from a lending—from an estate planning, from an advantage point actually provide a very unique opportunity, some of the things that Michelle is talking about. Two sides of the same coin. Nick, I want to scratch out a couple of things that you were hitting on. Could you go a little deeper? This market fluctuation, being down so much, being up so much, talk about how your team from a tax point of view has been able to take advantage of those dislocations to our clients' benefits as it relates to the harvesting of losses and rebalancing the portfolio and limiting taxes.

**NICHOLAS:** Sure. Absolutely. I think it's funny, we oftentimes hear clients say, you know, when you're harvesting losses, you're selling things that are down, how is that a strategy? We tend to agree with them on that. It's—there's a lot more that goes into it to make it really valuable, and that's, again, as I mentioned earlier, it's rebalancing the portfolio when things are suddenly moving very quickly not only to manage risk but also to take advantage of opportunities that are suddenly out there, but not just rebalancing to back where you were, taking the advantage of that rebalancing to reposition the portfolio to be in a better spot for potentially what we're going to have to navigate through going forward. And at the same time we do that, implement a tax management and tax-loss harvesting strategy. What you buy when you tax-loss harvest something on that same trade, what you rebuy back into is just as important as getting that tax-loss harvesting. And when you do the rebalancing, repositioning in tax management all in one motion, that's where the value is, that's where the real value is because you don't lose sight of the importance of keeping the investment objective in line because that's what makes your plan work, as Michelle has been talking about. And you stick to a strategy. You stick to the playbook and you stick to this to reposition now. Certainly, you're getting a lot of tax-loss harvesting and clients sometimes feel like they don't need all of that, but as we lived through this in '08 and '09, when the sharp recovery came back after that first or that big drop in '08 or '09, we saw our clients who had harvested a lot of losses during that time, over the next couple of years, use those up very quickly. As risk assets come back, capital gains build up, and you want to continue to manage risk along the way, and that means you may have to take capital gains. If you can offset them with your losses, consider it a very efficient future rebalance. In a multi-account approach, we've seen some really interesting opportunities to improve the portfolio. Suddenly, you have portfolios that may have been given to us with older legacy positions that clients already had or they had capital gains in those positions on the taxable side of the portfolio. We weren't able to move those around much because it would have cost our clients a lot of taxes. As the markets suddenly went down, we could tax-loss harvest some of those positions. We can start to sell certain things in the taxable portfolio like international equity at losses or small gains. And instead of rebuying them back on the taxable side, we rebuy those back on the retirement side. International equities tend to be, by their nature, a little less tax-efficient than your traditional U.S. equities in other things because the make-up of the industries and sectors in those markets tend to be a little more dividend-heavy. So let's be smart about where we rebuild your asset allocation and put those back over on the IRA side. Again, use the taxable side to get even more focused on hyper tax-efficient vehicles, municipal bonds, separately managed stocks leads where we know we can do future tax-loss harvesting real easy, there's liquidity, and we can also employ buy and hold type strategies for the future, more all-weather things that we don't have to move around and we can defer gains on. So all of this comes together in a diversified allocation. You don't lose your overall diversification, but you take advantage of this dislocation in the markets to reposition things to be more efficient for the future.

**ROGER:** Our clients are going to want to know how to do it. It's May. How have we done so far from an after-tax perspective relative to our benchmarks? How are we doing from your perspective?

**NICHOLAS:** You know, from an after-tax perspective, as you measure in the benefit of some of that tax-loss harvesting, we're seeing some really good—some really good performance on that. And we're happy about it. As we see things unfold in terms of pre-tax performance, how have you behaved in these markets, you know, it's still one of those things where if you look at it week by week, there are things moving all over, which is why we have the portfolio's position to be right now in a recessionary standpoint. There might be up weeks. There might be down weeks. But that's not the type of volatility you make long-term positioning portfolio moves on. What you need to do is be wary that we are going to be potentially in what looks like an economic recession, prepare the portfolios for that volatility long-term, and make sure that we get through this full cycle and we come out of this, as we will, in the right position to get those long-term returns in the portfolio back where we were.

**ROGER:** Okay. Well said. Michelle, let me put it back to you and ask a couple of questions about how do you see the integration of what we do from a financial and estate planning point of view with the investment work that Nick is talking about? How—I know we think about them as interwoven. Talk a little bit about from your perspective on how important it is for those two groups to be in a synchronistic situation.

**MICHELLE:** Well, I think, you know, we really need to understand the client's goals. Right? That's number one. And making sure that our plans align with the investment goals as well or the investment positions. We really can't go forward and have a successful financial plan if we're not understanding what the investment portfolio is meant to do and the asset allocation and the goals—I'm sorry, the risk tolerance. They really have to be aligned in order for the plan to be successful.

**ROGER:** Great. Would you mind as a part of this pandemic and massive fluctuation some legislation has come into the mix, CARES, Secure Act. Could you educate us about the opportunities there and some of the things that people don't have to do or maybe should be doing as a result of both of those programs?

**MICHELLE:** Yeah, sure. Both of these acts have impacted retirement accounts, most notably the Secure Act has changed the required minimum distribution age, or the RMD age, the age where you have to take distributions out of your retirement accounts from 70.5 to 72, so we're provided with another year and a half of tax-deferred growth. And the CARES Act provides for client—provides clients the opportunity to skip the required minimum distributions in tax year 2020. Additionally, the Secure Act made significant changes to retirement accounts inherited after 2020. So under the Secure Act, most non-spousal beneficiaries - not all but most, there's always a fine print—will no longer be able to stretch distributions from an inherited account over his or her life expectancy. This act has limited the distribution period to ten years. That's a significant change. And due to that change, I would say that it's particularly important for clients who have say a revocable trust listed as a primary or contingent beneficiary on their retirement accounts to speak with their planners and their advisors to say, hey, does my trust document and the beneficiary designation that I have, does this all still jive with my overall plan. And if not, to make any shifts for the new legislation.

**ROGER:** Great. Nick, same question to you. Talk a little bit about your perspective around the integration between the investment piece as well as the financial and estate planning piece. What is your advice to our clients around thinking holistically just like Michelle said?

**NICHOLAS:** Yeah. I think, you know, obviously, the asset mix has to fit in with your plan because that overall asset mix is going to be the biggest driver of your outcomes long-term and making sure you're accomplishing your goals. In order to do that well, you have to be nimble. You have to be able to adjust those portfolios quickly if needed as things change, as you change your plan, as you might move assets around. And I think a really good example happened with this recent legislation that happened where people no longer have to take their minimum distribution in 2020. We saw an interesting strategy we were able to employ for certain clients where they didn't have to take it out of their IRA anymore, which is a good thing because you can avoid that taxable income, but there were many clients who still felt like they wanted to get some liquidity still, but they didn't want to pay a lot of taxes to get it. So what we've done in our multi-account structure, we have both taxable accounts and IRAs working together, is we actually went into the taxable account, found the most tax-efficient way we could find in that portfolio to generate whatever liquidity amount was appropriate for that client at that time based on what they worked with our planning team and our wealth management advisors on, get it out tax-efficiently, then use the IRA to basically if you could visualize build around what's left in that taxable account so that we keep intact with our overall investment strategy. We stay diversified. We keep the positioning of the strategic allocation that we want in those portfolios. But we can do it—we can raise the liquidity in a very customized way on that taxable account in a very tax-efficient way. So this was a strategy we were able to pivot to really quickly called—what we call smart withdrawal basically or smart income, that we could pivot to really quickly based on the changes that are happening out there.

**ROGER:** I want to thank you both for your expertise. I want to thank you for your commitment to our clients as well as to your craft. It's nice to have a team—being surrounded by a team of experts the way that we are.

I wanted to close by saying a couple things. First of all, I want to thank our clients for their continued loyalty and support as well as feedback that we've been getting throughout this particular process, throughout this particular market dislocation situation that we're dealing with as a world, as a country, as economy, and as a firm. This technology is fantastic. We as an organization have pivoted in a way so that we haven't skipped a beat around our ability to provide our offering. And as a private wealth management client at the center of our offering is our ability to provide great service. Hopefully you're getting that and that hasn't skipped a beat. On top of that, for the Fidelity Wealth Services clients that we have within Private Wealth Management, we've got additional advice and access to the Michelles and the Nicks of the world to help provide deep, meaningful expertise around estate planning, financial planning, as well as investment management. And then at the end of the day, our commitment to you is to help you and your family deal with the intergenerational wealth opportunities as well as challenges. So as I mentioned at the top of the hour, this is going to be an ongoing conversation. We're committed to having it be a back and forth. Please take this as an opportunity to continue to be part of this conversation, but also take this as an opportunity to get with your advisor, to get with your team to make sure that your plan is on track, to make sure that your plan is taking advantage of these opportunities and challenges. And that's what we live to do. You don't know what you don't know. We're trying to help fill in that particular gap. Please take this as an opportunity to reach out to us and to your relationship management and your wealth management advisor team so that we can play a role in helping you take advantage of these opportunities and deal with some of these challenges. So, with that, I thank you again for your time, and look forward to talking again soon.

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