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Cumulare Asset Management

Bridging the Past and the Future: Investing for Generational Wealth – The Red Tips Method

by Alan Miller CFA FIA May 18th 2018

This presentation expresses our opinions and does not constitute investment, legal or tax advice

Cumulare Asset Management: Info

- **Cumulare is a Registered Investment Advisor (RIA)**
  - Registered with Florida Office of Financial Regulation (CRD# 288846)
  - Separate Managed Accounts for each of our clients
  - Independent Custodian is Interactive Brokers LLC
- **Alan Miller, CFA**
  - Fellow of the Institute of Actuaries in London, Investment specialization
  - Ex-CEO of Barclays' South African investment management business
  - Expert in applying quantitative tools to asset management
  - Equity orientation, but experienced in all asset classes
- **Stuart Brisgel**
  - John Abbott College in Montreal, ex-Morgan Stanley
  - Developed PowerOne Strategy for preferred securities
  - Passion for finding and exploiting market inefficiencies
  - Fixed income & preferred security orientation

Investing for Generational Wealth

- "Generation" = About 30 year time span
- Taking long term view on investment performance
- Idea is to pass on as much wealth as possible to subsequent generations….
- …while managing the risks and pitfalls that can get you off track
- No magic formula, but some key factors to consider
- Summarized list of key factors: **"RED-TIPS"**

RED-TIPS

- Maximize long term **RETURNS** by investing mainly in equities (common stocks)
- Start as **EARLY** as possible
- **DIVERSIFY** your investments
- **TAX** efficiency
- Use Advisor with an **INDEPENDENT** Custodian
- Develop a written **PLAN** and stick to it
- Have the right legal **STRUCTURE** for your investments

Historically Equities have given great long term Returns

Compound Annualized Returns in USD from 01/01/1987 through 04/30/2018. Based on published Index Performance before any fees or charges:

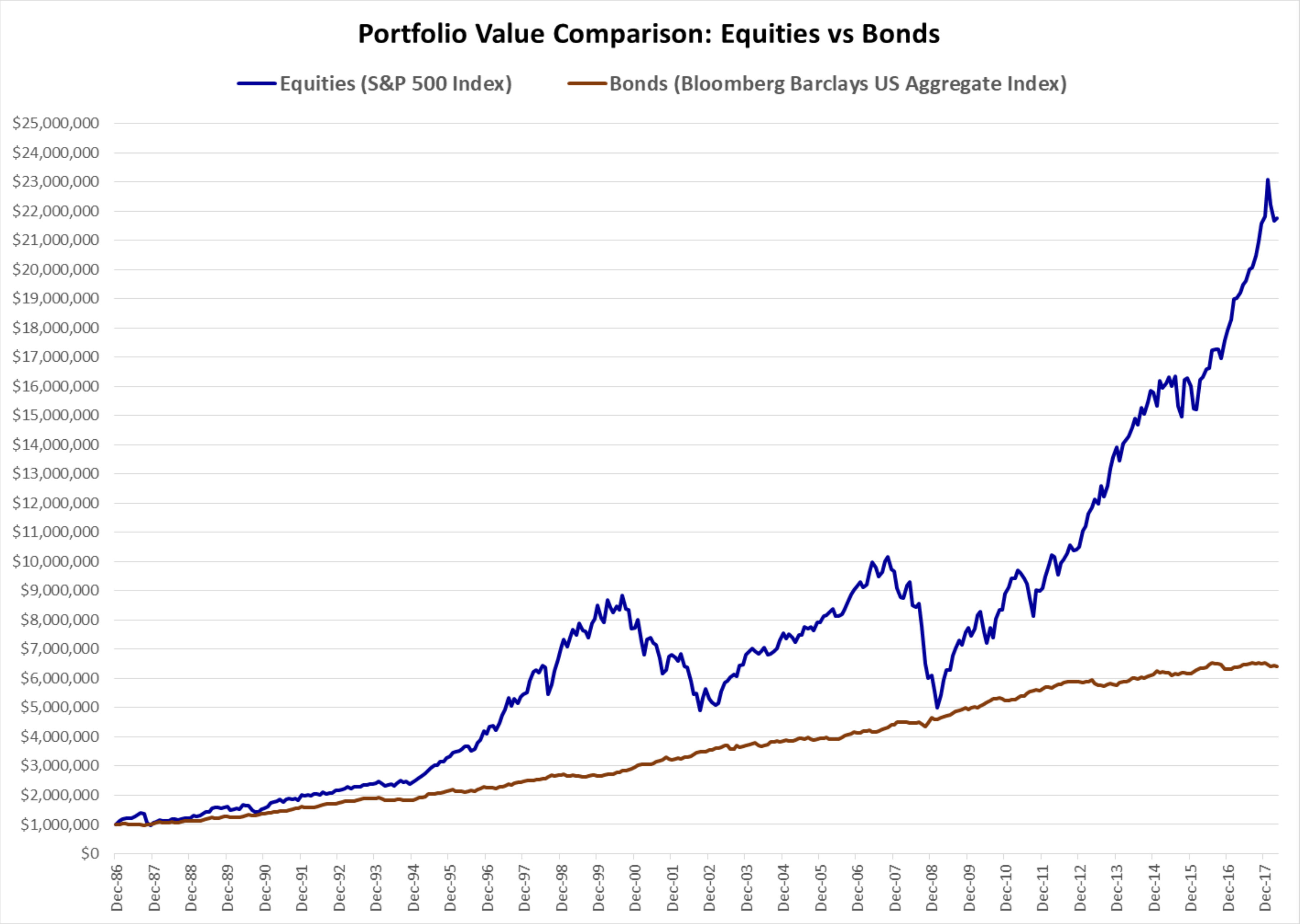
US Equities:	10.3% p.a.	S&P 500 Index, Total Returns
US Growth Equities:	13.6% p.a.	Nasdaq 100 Index, Total Returns
US Bonds:	6.1% p.a.	Bloomberg Barclays US Aggregate Bond Index, Total Returns
US Inflation:	2.7% p.a.	US Consumer Price Index, Urban Areas

Why do Equities usually perform well over the long term?

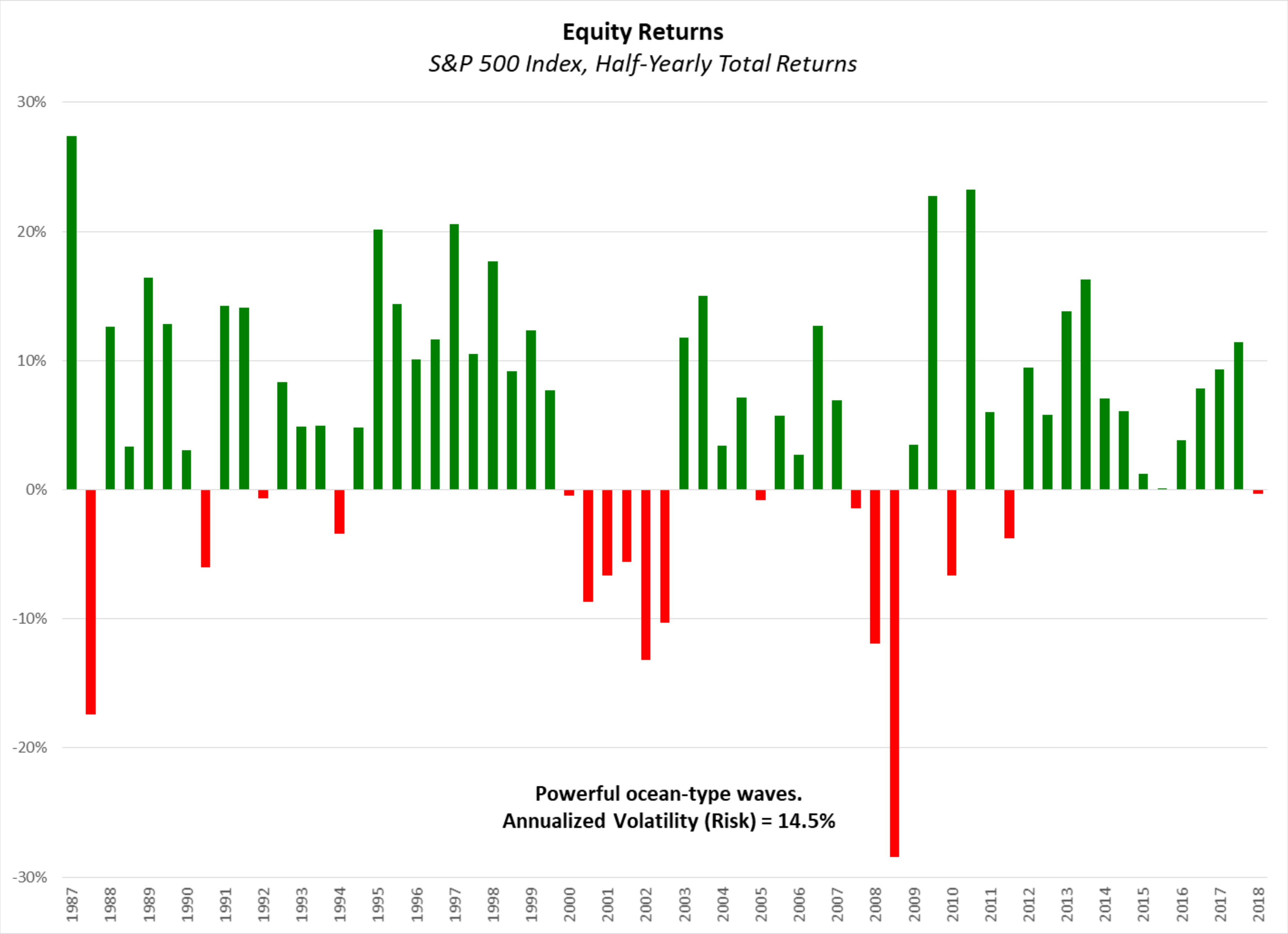
- Equities (common stocks) represent an entitlement to the profit stream of the underlying corporations.
- Over time, as the economy grows, corporate profits grow, and corporations pay higher dividends to stockholders.
- In the long run, inflation should flow through to corporate profits, therefore equity investors are somewhat protected against changes in inflation.
- Your long term return from equities is the sum of:
  - The dividend yield (current dividend / stock price) e.g. 2.5%
  - Growth in earnings and dividends over time (real economic growth + inflation, maybe 3% + 2.5% = 5.5%)
- Long term historical returns from U.S. equities have been 8-12%, which is more than most other asset classes.
- “Growth” equities (e.g. Nasdaq-listed common stocks) have outperformed the general equity market, but with much higher volatility and risk.

Long Term Return Comparison

- Slightly more than 30 years, want to include 1987 because want to include impact of the “Crash of 1987”
- Assume that you started with $1 million on 01/01/1987.
- Invested in a diversified portfolio of Equities (S&P 500)or Bonds (Bloomberg Barclays US Aggregate Index), before Taxes and Investment Charges, and assuming that all dividends and interest are reinvested.
- **Accumulated Portfolio Values as of 04/30/2018:**
  - **Equity Portfolio = $21,759,669**
  - **Bond Portfolio = $6,397,775**
- Equities outperformed bonds by a huge margin and are much more volatile…but if you are investing for generational wealth, maybe you need to “look through” the volatility?



Figures shown are based on index data and assume reinvestment of income. No fees or taxes have been deducted.


Equity Returns
S&P 500 Index, Half-Yearly Total Returns
30%
20%
10%
0%
-10%
-20%
-30%
1987
1988
1989
1990
1991
1992
1993
1994
1995
1996
1997
1998
1999
2000
2001
2002
2003
2004
2005
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2011
2012
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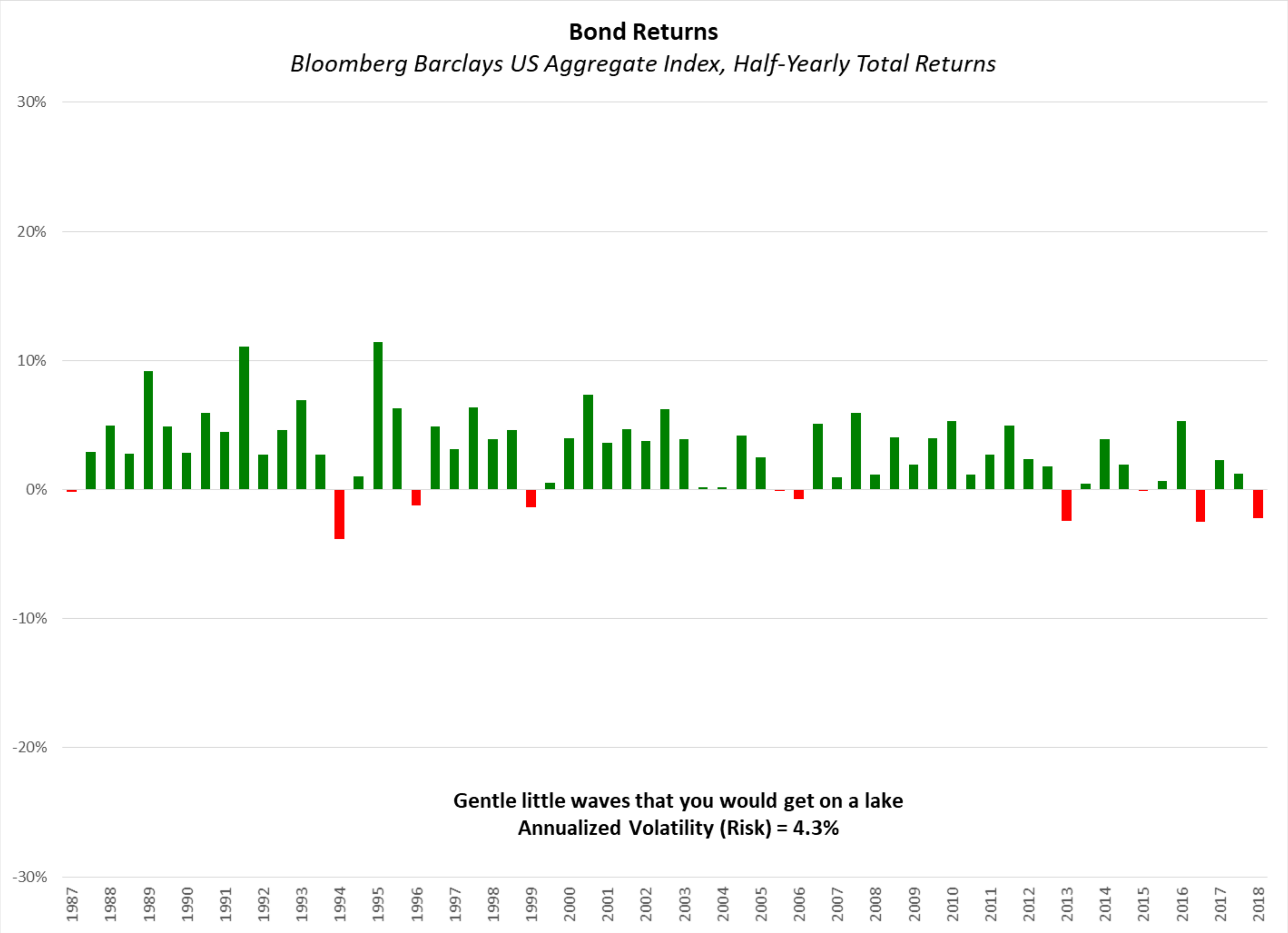
2014
2015
2016
2017
2018
Powerful ocean-type waves.
Annualized Volatility (Risk) = 14.5%


Bond Returns
Bloomberg Barclays US Aggregate Index, Half-Yearly Total Returns
30%
20%
10%
0%
-10%
-20%
-30%
1987 1988 1989 1990 1991 1992 1993 1994 1995 1996 1997 1998 1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012 2013 2014 2015 2016 2017 2018
Gentle little waves that you would get on a lake
Annualized Volatility (Risk) = 4.3%

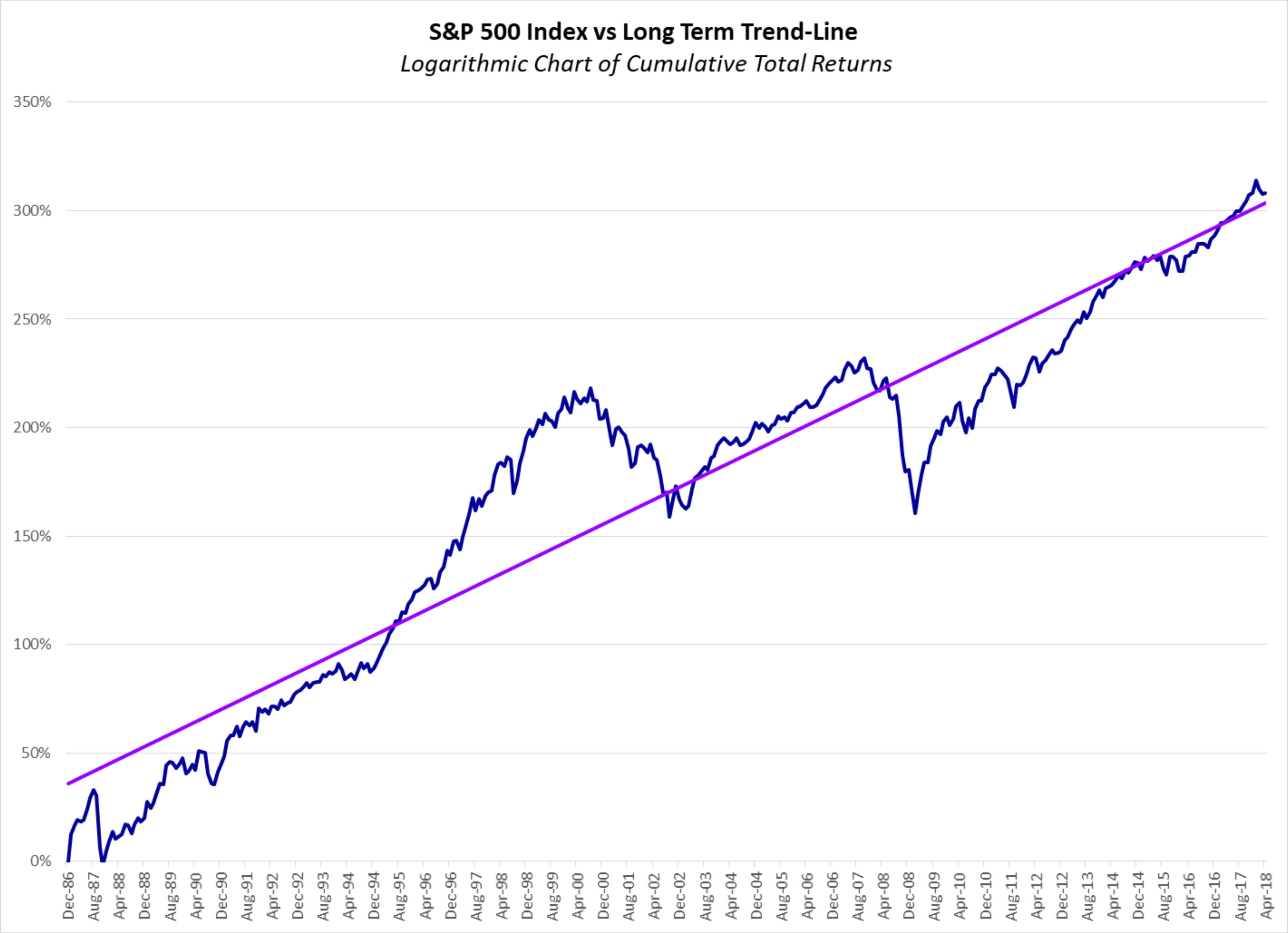
Are Equities Over-Priced Right Now?

Long Term Growth Trend-Line

- If we take 01/01/1987 as the base, the current level of the S&P 500 is very close to its long term growth trend-line, which suggests that equities are not currently over-priced.
- The trend-line was calculated using a linear regression of logarithmic cumulative returns.

Price : Earnings Ratio

- The Price : Earnings (P/E) Ratio of the S&P 500 Index, is a measure of how many years' earnings are reflected in the current index value. The greater the ratio, the more expensive is the S&P 500, relative to its current earnings.
- The current P/E Ratio on the S&P 500 is 20.8 times, versus a long term average (1987-2018) of 19.3 times.
- On this basis, the equity market appears to be slightly over-priced right now…but does that really matter if your time horizon is 30 years?


S&P 500 Index vs Long Term Trend-Line
Logarithmic Chart of Cumulative Total Returns
350%
300%
250%
200%
150%
100%
50%
0%
Dec-86
Aug-87
Apr-88
Dec-88
Aug-89
Apr-90
Dec-90
Aug-91
Apr-92
Dec-92
Aug-93
Apr-94
Dec-94
Aug-95
Apr-96
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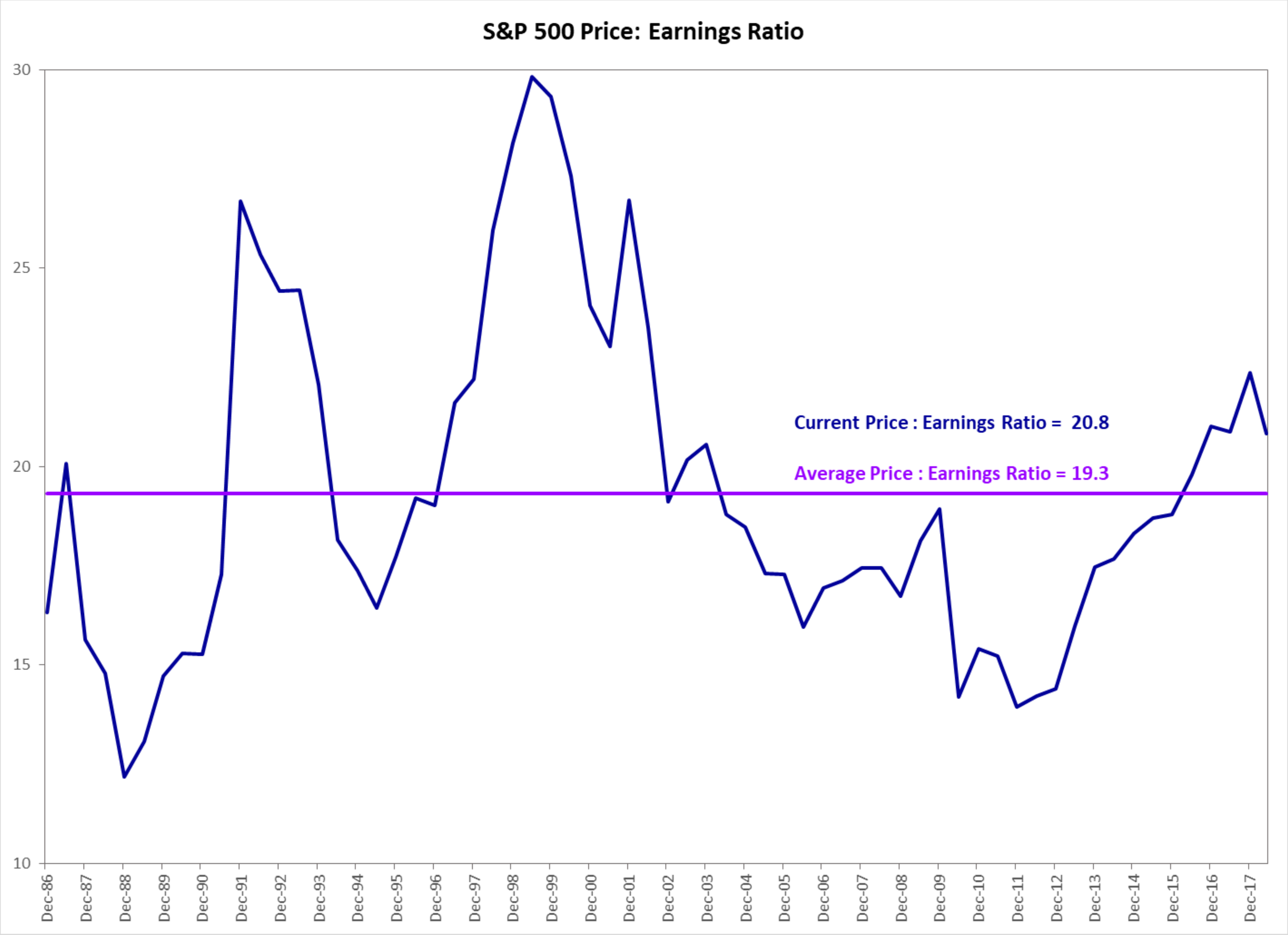
Dec-16
Aug-17
Apr-18



S&P 500 Price: Earnings Ratio
30
25
20
15
10
Dec-86
Dec-87
Dec-88
Dec-89
Dec-90
Dec-91
Dec-92
Dec-93
Dec-94
Dec-95
Dec-96
Dec-97
Dec-98
Dec-99
Dec-00
Dec-01
Dec-02
Dec-03
Dec-04
Dec-05
Dec-06
Dec-07
Dec-08
Dec-09
Dec-10
Dec-11
Dec-12
Dec-13
Dec-14
Dec-15
Dec-16
Dec-17
Current Price : Earnings Ratio = 20.8
Average Price : Earnings Ratio = 19.3

DIVERSIFY Investments

- High volatility of equities means that 100% in equities is not usually appropriate.
- Some Asset-Class Diversification is normally advisable
- Most common asset mix is 60% equities, 40% bonds
- An equity portfolio should also be diversified by:
  - Sector (e.g. Banks / Technology / Consumer / Industrial)
  - Individual stocks (e.g. for Tech sector: hold a mix of Apple, Amazon, Alphabet, Facebook, Netflix...not all in one stock).
- A bond portfolio should be diversified by:
  - Maturity date
  - Issuer (and preferably, only consider investment-grade issuers)
- The combined exposure to any one corporation (equity + bond holdings) should not exceed 10% of the portfolio value.

The Magic of Diversification: Combining Uncorrelated Assets Reduces Risk

Equity Volatility	**14.5%**
Bond Volatility	**4.3%**
Average (50:50) Volatility of Equities and Bonds	**9.4%**
Actual Volatility of 50:50 Balanced Portfolio	**7.6%**
"Free Lunch" Reduction of Risk	**1.8%**

Start as EARLY as possible

- Einstein said: “Compound interest is the most powerful force in the universe”.
- When positive returns are reinvested, growth takes place on a bigger capital base and returns “compound”.
    - 41% + 41% = 100%
    - 25% + 25% + 25% = 100%
- The longer you can keep investing, the greater the power of compounding.

What Age Should You Start Investing?

- Consider three people earning the same salary, of $200 000 per annum at age 30, who invest 10% of their salary.
- Assume:
  - investment returns: 8.0% p.a.
  - salary increases: 4.5% p.a.
  - CPI inflation 2.5% p.a.
  - No tax or charges
- **Real (Inflation Adjusted) Value of Capital at Age 65:**
  - **Started at 30: $2.55 million**
  - **Started at 40: $1.50 million**
  - **Started at 50: $0.75 million**

Tax System Favors a Long Term, Equity Oriented Portfolio

- For a long-term oriented equity portfolio, with infrequent transactions (low turnover), returns are typically in the form of:
  - Long term capital gains
  - Qualified Dividends
- Both of these items are taxed at the Long Term Capital Gains Tax Rate (maximum rate currently 20% + 3.8% NIIT = **23.8%**)
- Fixed Income / Bond Returns are generally taxed as regular income (maximum rate **37%**).
- A short-term trading oriented portfolio (equities or bonds) will be taxed on short term capital gains (maximum rate **37%**)
- Retirement accounts like IRAs and 401(k)s offer additional tax advantages.

Independent Custodian

- Avoid a Madoff-type scenario.
- For your protection, the firm that manages your assets, should not also have custody of your assets.
- Best practice is to choose an investment manager with a large independent custodian (e.g. Cumulare uses Interactive Brokers LLC).
- The Independent Custodian ensures that, while the investment manager can buy and sell assets for the client's benefit, any transfers of money out of the Account, can only go to the client, or as authorized by the client.

Stick to your Plan

- Having a well thought-out and <u>written</u> investment plan, helps to defend you from the waves of emotions that can affect you in situations of market volatility.
- The most common mistake is buying or selling investments in response to news and day-to-day "buzz". This can happen anytime, but is most common when markets are moving wildly and emotions are running high.
- When you are tempted to make ad-hoc changes, force yourself to first read through your written plan.
- Equities generally provide the best long term returns, but they easily lose 30% of their value in a short period of time. If you can't handle this, then don't invest 100% of your assets in equities.
- Don't try to "time" the equity market by jumping in and out. In our experience, most people who do this, land up much worse-off.
- Review your plan annually with your Financial Advisor.

The Right Legal **Structure**

- Key point is that you want to build up a pool of assets for the benefit of your family, which is independent of your day-to-day business affairs and protected from your creditors as far as possible.
- In many cases, “ERISA” retirement accounts like 401(k)’s and IRAs provide protection from creditors, as well as multiple tax advantages.
- Trusts can be used, in some circumstances, to:
  - Ensure that assets are properly managed and distributed after your death
  - Protect assets from creditors (but only if the Trust is “irrevocable”)
  - Avoid Probate and reduce or eliminate Estate Tax
- Get professional advice on the right legal structure for you and your family.

Disclaimer

Investment performance figures quoted are based on gross index performance, before fees and charges. This presentation is intended to illustrate some high-level investment concepts and principles. It is not intended to provide, and should not be relied upon for, accounting, legal, or tax advice or investment recommendations. You should consult your tax, legal, accounting, or other advisors about the matters discussed herein. Investment returns may also may be affected by a variety of risks not discussed herein. No representations or warranties of any kind are made or intended, and none should be inferred, with respect to the economic return or the tax consequences from any investment strategy. No assurance can be given that existing laws will not be changed or interpreted adversely. Prospective investors are not to construe this presentation as legal or tax or investment advice. Each investor should consult his or her own counsel and accountant for advice concerning the various legal, tax, ERISA and economic matters concerning his or her investments. A prospective investor should only commit to any investment strategy if such prospective investor understands the nature of the investment and can bear the economic risk of such investment. It is possible that a particular strategy's investment objectives will not be achieved, and the investment results may vary substantially from year to year or even from month to month. As a result, an investor could lose some or all of his capital. In addition, a strategy's fees and expenses may offset its profits. In making an investment decision, you must rely on your own examination of the proposed strategy and the terms of any investment agreement.

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