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IQ

33rd Edition | Spring 2016

Investment Quarterly

Equity Markets: Is the Fog Starting to Lift?

After a first quarter during which equity markets took us for a wild ride, the second quarter finds us looking for direction. March's strong rally recovered the significant losses in January and February, and the global equity markets currently sit at valuations that appear fair, but not cheap. Near-term visibility is lacking due to ongoing questions about global growth, the corporate earnings outlook, U.S. inflation and the path of interest rates. An unpredictable U.S. election cycle is also creating headwinds, which may persist as we head toward the national conventions. As these issues begin to take on more definition, we continue to favor an approach of selectivity in pursuing risk assets.

In this edition of *Investment Quarterly*, we examine the election's potential impact on the health care sector; seek to understand how emotional reactions to market pullbacks can influence investment decision-making; assess the value of a Roth IRA conversion; and offer insights for changing your domicile to Florida for state tax purposes. We hope you enjoy *IQ* and encourage you to contact your financial advisor with questions.

Joseph V. Amato
President, Chief Investment Officer—Equities

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HIGHLIGHTS 2Q16

FROM THE ASSET ALLOCATION COMMITTEE OUTLOOK

EQUITY: Developed Market Non-U.S. Equities in Favor
Global equities—particularly those in developed markets outside the U.S.—may provide more opportunities over the coming 12 months.

FIXED INCOME: High Yield Opportunity Persists Near Term
High yield fixed income, particularly short-duration issues and higher-rated credits, remains in favor given current prevailing yields and the outlook for credit quality.

ALTERNATIVES: Selective Opportunity in Hedge Funds, Private Debt
Despite challenges, the Committee maintained a slightly overweight view on lower volatility and directional hedge funds; meanwhile certain areas within private debt appear attractive.

This quarter, we're watching:

1. U.S. primary calendar leading up to national conventions in July
2. Signs of improvement in global purchasing manager indices
3. U.K. European Union membership referendum on June 23
4. Supply and demand data across commodity markets, particularly energy
5. Global central bank meetings and policy announcements

ASSET MATTERS

JUST STOP THE PAIN

Richard Gardiner, Head of Investment Strategy
Justin Gaines, Investment Strategist

Understanding emotional reactions to market pullbacks can improve investment decisions

If your portfolio has experienced a prolonged period of capital gains, a market pullback may not concern you because you may feel like you're "playing with house money." The prospect of further losses or losses that erode principal, however, can produce significant anxiety and spur a desire to protect remaining gains. Unfortunately, the response to this anxiety may be to abandon carefully laid investment plans, which can derail long-term goals.

EMOTIONS IN THE DRIVER'S SEAT

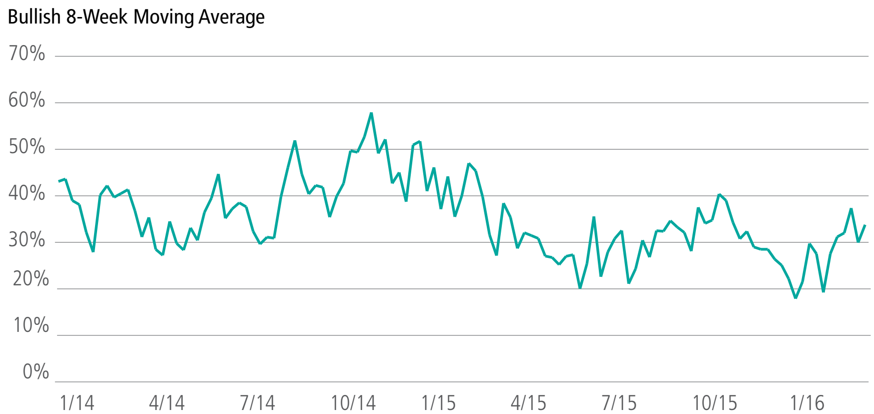
Is this type of reaction rational? Stock markets have been volatile since mid-2015, but several quarters on, global central banks remain accommodative, the economy continues to expand and corporate profits remain healthy. Market swings, however, may matter more to investor emotions than a collection of positive data points. This underscores an idea that has garnered plenty of research support: Investing is not always rational. In fact, it's often quite emotional.

The human inclination toward pessimism in response to the first signs of market loss results from a tangled web of psychological tendencies. The field of behavioral finance—which combines elements of psychology and finance in an effort to understand investors' decision-making processes—seeks to untangle these forces. The concept of loss aversion, for example, refers to the human tendency to feel the sting of losses more acutely than the pleasure arising from the same magnitude of gains—a key factor in how we respond to market pullbacks. By evaluating potential weak points in our thinking, the hope is that we can ultimately steer ourselves away from making poor investment choices.

ASSET MATTERS

Stock market pullbacks are often quickly followed by plummeting investor outlooks. A real-time example: After the tumultuous summer of 2015 for global equity markets, a weekly poll that tracks investor sentiment showed that the percentage of investors who characterize themselves as "bullish"—meaning that they expect stock markets to go up in the next six months—had declined to a 30-year low.[1]

BULLISH SENTIMENT OFTEN DECLINES WITH STOCKS



Source: American Association of Individual Investors.

Tracking Shifts In Risk Tolerance

Of the many factors that influence portfolio design—risk tolerance, time horizon, asset class preference, and income and liquidity needs—risk tolerance is often key. Yet investors' profound emotional reactions to bumpy markets beg the question, how stable is risk tolerance? If an investor's risk tolerance changes in up markets compared to down markets, is a "moderate" investor always a "moderate" investor, or does one become "conservative" when markets are falling and "aggressive" when markets are climbing?

The evidence that investors become conservative at exactly the wrong time is plentiful. For example, we can track how mutual fund investors move to higher cash allocations *after* markets begin to fall—woeful timing that can lock in losses and set them up to miss a potential market rebound. An investor's unwillingness to ride out downturns can undermine the foundation of a well-thought-out, long-term, strategic asset allocation.

Researchers have explored the pervasiveness of this tendency for risk tolerance to shift with market movements. One study tracked the risk tolerance of a group of investors between 2007 and 2012 and compared it with movements in the S&P 500 during that period.[2] The study's authors, two university professors of financial planning, had the good fortune of capturing the market as it went from an all-time high through one of the deepest pullbacks in stock market history and back up again—a period tailor-made to showcase the full spectrum of investor emotions.

The study found that risk tolerance scores were indeed highly correlated to S&P 500 levels, registering an overall correlation of 0.7. (Correlation is a statistical measure in which 0 suggests that two things are completely unrelated and 1 shows perfect interrelation.) Monthly risk tolerance scores showed a tendency to increase when stock values were high and decrease when stock values were low. The correlation increased to 0.9 when the S&P 500 was down.

[1] Source: AAII Investor Sentiment Survey, as of March 23, 2016. The 30-year low refers to the eight-week rolling average of investors reporting that they are bullish.

[2] Source: Guillemette, Michael and Michael Finke. 2014. "Do Large Swings in Equity Values Change Risk Tolerance?" *Journal of Financial Planning* 27 (6): 44–50.

Put simply, investors demonstrated less willingness to take on risk as stock market valuations became more attractive and vice versa, and the effect was particularly pronounced during down markets.

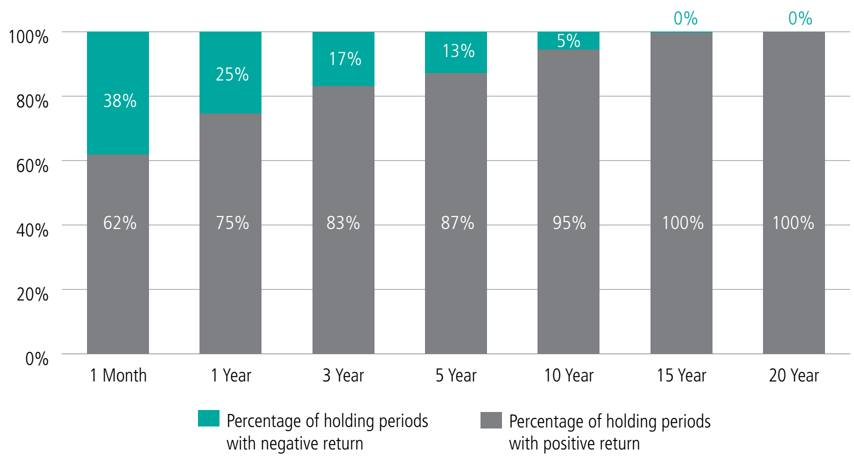
Fall into Good Habits

By becoming aware of our potentially problematic investing practices, we can take steps to institute positive changes. Just as you can lure yourself into forming bad habits that work against you, it's also possible to learn better ways to do things—to fall into good habits.

Once you've set up a process and a plan that makes you comfortable, you can take advantage of the upside of procrastination. Keep it going and, if possible, don't think about the funds as long as possible. Historical data has shown that the longer the investment period, the better the chances of achieving attractive returns (see chart). Periods of volatility are to be expected when investing for the long term.

An investor's unwillingness to ride out downturns can undermine the foundation of a well-thought-out, long-term, strategic asset allocation.

PERCENTAGE OF POSITIVE S&P 500 OUTCOMES HAS VARIED BY HOLDING PERIOD



Source: FactSet. Indexes are unmanaged and are not available for direct investment. Investing entails risks, including possible loss of principal. **Past performance is no guarantee of future results.**

For most investors, the salient point is to know how common this effect is, when it comes to our feelings about recent losses and the immediate future. Much like we all know that it's a bad idea to go grocery shopping when you're hungry, we would suggest that evaluating your portfolio design right after a pullback or market loss is likely to be colored by a greater tendency to avoid risk. Being aware of the most common reactions to market pullbacks can help reassure investors that their emotions are quite normal, but their long-term plans are still intact.

MATTER OF DEBATE

A RETURN TO SMALL-CAP QUALITY?

Robert D'Alelio, Portfolio Manager, Small Cap Value Team
Benjamin Nahum, Portfolio Manager, Small Cap Intrinsic Value Team

After a period of small-cap underperformance, the focus may shift to fundamentals

We are taking a measured approach to adding new ideas to our portfolios and are demanding a higher-quality investment, not simply an inexpensive stock.

Small-capitalization equities have underperformed larger stocks over the past year, and experienced a particularly rough stretch of negative performance in the second half of 2015 and into early 2016. The Russell 2000 Index, a popular benchmark for smaller stocks, declined more than 25% from its peak last June through a low in February of this year. To assess risks and opportunities in small caps, we tapped into the insights of two of Neuberger Berman's small-cap equity managers, Benjamin Nahum and Robert D'Alelio.

BENJAMIN NAHUM: Contrasting today's market for small-cap stocks with June of 2015, we see significantly more value but with greater volatility. A year ago it was the inverse. Arguably the current environment presents more challenges, including economic deceleration and uncertainty with regard to China and central bank policy, but for long-term investors, we see a far more appealing value equation in small-cap equities today than there has been in quite some time.

ROBERT D'ALELIO: When prices get lower, stocks can become more attractive, provided your time horizon is sufficiently long. It's worth noting, however, that lower prices don't necessarily equate to an attractive small-cap market. Roughly one-third of the companies in the Russell 2000 are projected to lose money over the next 12 months, so selectivity is important. This is one reason we think small-cap equities is an area that stands to benefit from active management.

NAHUM: To put our thinking on the attractiveness of current valuations into context, our strategy's "intrinsic value" discount metric exceeded historical averages in February. In our view, a "cheap" or truly distressed market would mean an intrinsic value discount north of 40%. This happened three times in the past 18 years, during periods of global financial panic or systemic risk. We believe our strategy's current intrinsic valuation discount represents an attractive entry level of value. If you think there is a crisis lurking out there, then there could be more downside based on what we've seen in the past. Absent a crisis, the current discount to intrinsic value is appealing.

D'ALELIO: To us, the overall market does not look particularly cheap on an absolute basis, but we don't buy the overall market. We buy individual securities, and we focus on high-quality companies with strong balance sheets, high levels of free cash flow and high returns, with barriers to entry. Until recently, in the post-financial crisis recovery, high-quality businesses like the kind we prefer have lagged. Low rates have helped highly leveraged companies and hurt companies with net cash balance sheets. In this sense, corporate savers are no different than individual savers who have been punished by Fed policy. Clearly cash is a "non-earning" asset today, however it can always be converted into an earning asset via share repurchase, acquisition and so on. It follows that companies with net cash balance sheets have untapped earnings power. So while the market today does not appear to be attractive on an absolute basis, quality looks relatively cheap.

Identifying Attractive Opportunities

NAHUM: We are taking a measured approach to adding new ideas to our portfolios and are demanding a higher-quality investment, not simply an inexpensive stock. We look for companies whose share prices have underperformed the market and where there is a compelling value argument in terms of cash flow, earnings or price-to-sales. If our analysis suggests a discount of more than 30% to intrinsic value, we'll investigate further. The idea is to look for out-of-favor companies with strong value attributes, along with capable management teams and credible catalysts for a turnaround in the next three to five years.

D'ALELIO: Quality has been out of phase recently, but over a full market cycle, we believe the quality approach works. Small is thought to equate with sexy, new kinds of companies, but we buy established and perhaps even boring businesses with clear-cut barriers to entry. They tend to keep competitors out and generate substantial free cash flow. Because these are not the kinds of companies that need to access the capital markets, they often don't get a lot of attention from Wall Street analysts.

Advantages and Considerations of Small-Cap Equities

NAHUM: The small-cap marketplace has been inefficient and volatile, but over the long term, small-cap value, in particular, has attractive relative returns versus large caps, as measured by the performance of the Russell 2000 Value versus the Russell 1000 indices since 1979. One reason, in our view, is that managements of smaller companies are often owner-operators, rather than bureaucrats. They tend to be entrepreneurial and creative, and are often more innovative and faster to market than their counterparts in larger companies. We believe these are the people you want to partner with over long periods of time.

D'ALELIO: I agree. Also, the inefficiency in the small-cap markets is great for active managers. Why would you want to index inefficiency?

Are U.S. Small Caps Insulated from Global Risks?

NAHUM: Small-cap companies are sometimes thought to be insulated from global risks, but we think this is a bit of a red herring. The financial sector accounts for nearly 40% of the Russell 2000 Value Index, and about one-third of those companies are real estate investment trusts, one-third are banks and one-third are non-bank finance companies. U.S.-based, small-cap financial companies tend to have little global exposure. The same cannot be said, however, of small-cap technology companies. So if you want the entrepreneurial benefits of small-cap American tech or medical companies, as we do, you'll incur global risks.

D'ALELIO: I agree with Ben that, while small companies are in fact more domestically oriented than larger caps, simplistic analysis using SEC filings tends to overstate the magnitude. For example, this type of analysis would lead one to believe that small-cap energy companies are 100% domestic. While that's technically true, where is the price of oil determined? It's driven by global demand. While it's true that small companies are still somewhat more focused than larger ones on domestic markets, we don't think that should be a reason to embrace or avoid the space.

Outlook for Mergers and Acquisitions Activity

NAHUM: We tend to see a lot of acquisitions among our portfolio companies, and we view a company buying one of our holdings as corroboration of our process. Regarding the level of ongoing M&A activity, we think confidence goes hand-in-hand with liquidity and risk premiums, so we find that there is more M&A activity when financial markets and confidence are strong, and that M&A will ebb when markets weaken. Year-to-date, we have seen healthy M&A activity within our portfolios, suggesting that confidence among corporate buyers and private equity firms appears reasonably solid.

D'ALELIO: We experience our share of takeovers within our portfolios, but we tend not to like them unless the premium is very large. That's because we buy into unique, hard-to-duplicate business models. We'd rather own these companies and capture the benefits of earnings growth over the next 10 to 20 years than get a one-time premium and have to redeploy the cash into another company with similar attractiveness, which can be hard to find. As Warren Buffett has stated—the best time to sell a good company is never.

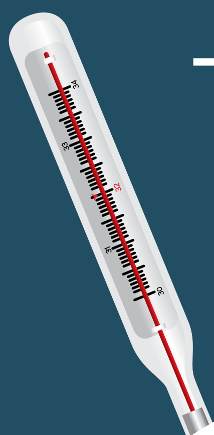
While it's true that small companies are still somewhat more focused than larger ones on domestic markets, we don't think that should be a reason to embrace or avoid the space.

SECTOR SPOTLIGHT
ELECTION
2016

TAKING THE TEMPERATURE

OF THE

HEALTH CARE SECTOR



Ari Singh, Health Care Analyst

UNCERTAINTY ABOUT **THREE KEY ISSUES** IS TRIGGERING MILD NAUSEA FOR HEALTH CARE INVESTORS

Health care finds itself in the spotlight again this election cycle. Candidates on both sides of the aisle have made it a wedge issue, with the Democrats touting the expansion of coverage through the Affordable Care Act (ACA/Obamacare) as a big win and Republicans countering that the law is invasive, a regulatory burden and a superfluous inflation driver. With no clear presidential frontrunner to date, the somewhat murky health care policy outlook has negatively impacted investor sentiment. As we head into the fall campaign, investors may be unlikely to embrace the sector until they receive clarity on three key issues: the future of the individual commercial insurance market, prescription drug prices and entitlement spending.

Hanging in the Balance: Individual Market Reforms

We currently have two main presidential candidates (Clinton and Trump) and two different agendas for reforming the individual market. This was the market most impacted by Obamacare and the one area most likely to be affected by future changes to the law. Hence, this is the market segment most likely to experience disruption if there are clumsy or shortsighted policy changes. Any policy change could impact over 18 million lives, so new regulations can't be taken lightly. The lack of insight into a future plan would create uncertainty for investors. Although Donald Trump has discussed "repealing and replacing" the ACA, his plan only reforms the individual market slightly and we don't see his vision as a game changer. Furthermore, we remain skeptical that Trump's plan would even be supported by Republicans on the Hill, so his Administration would likely be viewed as a wildcard by investors. On the flip side, Hillary Clinton is an outspoken supporter of Obamacare and has suggested that she would only tweak the program to strengthen it.

The Wild Card: Pharmaceutical Drug Pricing Regulation

Current law prohibits the federal government from interfering in private sector negotiations, including negotiating drug prices in the Medicare benefit. There are also no direct price negotiations in Medicaid, although manufacturers have to adhere to a set pricing formula to participate in the program. Investors want to know if Congress is willing to revisit the Medicare Part D law. While Clinton and Trump have expressed an interest in direct negotiations with manufacturers, it remains unclear how the next administration would implement a new program. To improve pricing, the government would likely have to threaten to deny manufacturers the ability to sell their product to seniors. While the concept of a national formulary doesn't sound too daunting, in reality it would be a political nightmare, triggering endless debates regarding which drugs should and should not be covered. At the end of the day, we would expect Congress to back off this idea and embrace more subtle changes, such as the recent reforms proposed by the Administration.

A Likely Scenario: Medicare Cuts

No matter who wins the White House, we believe it is highly likely that Congress will pass a bill that curtails entitlement spending. Nearly every president since Ronald Reagan has cut Medicare, so it wouldn't be a surprise to see a bill under the next administration. Fiscal hawks will be quick to point out that the expected doubling of annual entitlement expenditures to $2 trillion, or 40% of federal revenues in 2026, is simply unsustainable and that the imbalance will need to be addressed at some point. While pundits will haggle over possible solutions, Congress tends to return to a formula it knows well: reducing reimbursements to the provider community. While that can be unsettling

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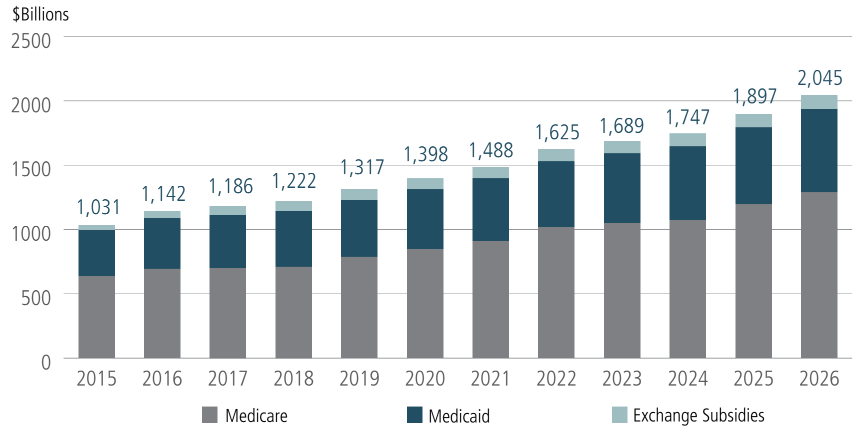
Although the upcoming election raises new questions for health care investors, we believe that future changes to the health care system will be more evolutionary than revolutionary.

for many investors, these types of cuts are usually watered down and can take years to implement, which often helps avoid the worst-case scenarios.

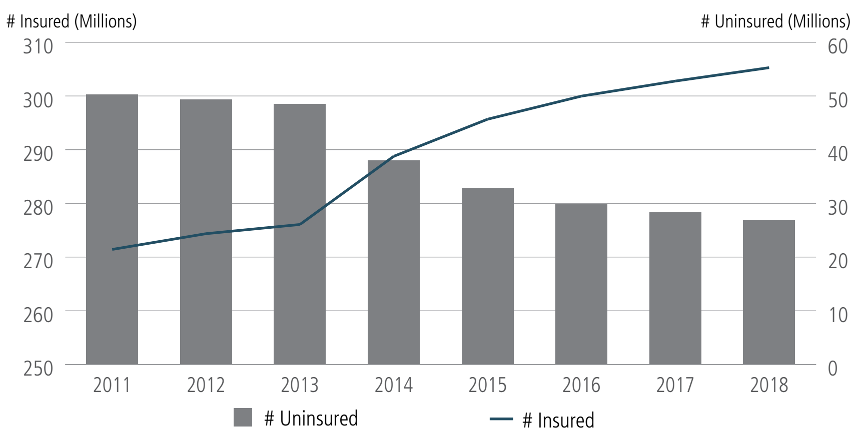
Although the upcoming election raises new questions for health care investors, we believe that future changes to the health care system will be more evolutionary than revolutionary—a sharp contrast to what we experienced in 2008 and 2009. Furthermore, the sector has always been nimble and able to adapt to policy changes. While that can take time, we believe that health care companies will continue to find a way to grow.

TOTAL FEDERAL SPENDING ON HEALTH CARE PROGRAMS
2015A – 2026E



Source: Congressional Budget Office report, January 2016.

HEALTH INSURANCE COVERAGE: NUMBER OF INSURED VS. UNINSURED AMERICANS



Source: GS/WFC data, company reports, Medicare Trustees report, CMS Medicare Advantage enrollment data.

THE PURPOSE-DRIVEN PORTFOLIO: EVALUATING THE SRI OPPORTUNITY

Evolving demographics and performance factors are fueling the growth of sustainable investing

In recent years, socially responsive investing (SRI or sustainable investing) has enjoyed significant growth, both in assets under management and the number of products available to investors across the asset class spectrum.[1] A number of issues, from demographics to data supporting sustainability as a positive factor in investment performance, have contributed to this rise and are emblematic of a growing consciousness about the impact investors can have in the promotion of a better world.

The Evolution of SRI and Emergence of ESG Factors

SRI in its myriad forms has long occupied a position at the intersection of mission and investing. While its earliest incarnations in the U.S. date back to religious organizations such as the Quakers and Methodists, modern-day SRI has its roots in the social movements of the 1960s, and gained steam in subsequent decades, when it was employed for mainstream purposes as well as in service of political activism, for example to help drive change in apartheid-era South Africa and war-torn Sudan.

During the last decade, the SRI mindset has evolved from a focus on the mechanics of industry avoidance (e.g., avoiding alcohol or tobacco companies) to a more formative, proactive approach that seeks to construct portfolios from the building blocks of companies with sustainable business practices. In 2007, the Rockefeller Foundation helped socialize this approach to SRI when it coined the term "impact investing" to refer to an investment program designed to produce measurable social or environmental outcomes alongside a financial return.

Alongside this shift, a set of evaluation criteria, known as Environmental, Social and Governmental (ESG) factors, has gained prominence as a means of assessing a company's sustainability alongside other key contributors to the bottom line.

Environmental factors seek to assess a company's impact on the environment, looking at a range of concerns, from its carbon footprint in light of climate change to pollution to the use of toxic chemicals, waste disposal and preservation of natural resources. An evaluation of a company's environmental impact will include an analysis of its upstream supply chain as well as its products and services.

Encompassing issues from a company's workplace conditions to its supply chain integrity, *social factors* have gained heightened visibility in recent years, and may include an evaluation of workers' rights, workplace safety and fair labor practices. In competitive industries, in particular, investors may be concerned about how a company can attract and incent a diverse workforce. This is particularly relevant for intellectual-capital intensive industries like financial services, research and development and technology where employees drive revenue and attractive workplace policies can give companies a competitive advantage.

In a publicly traded company, the role of *corporate governance* is to provide oversight to help ensure that management is focused and working on behalf of shareholders. Within the context of SRI, governance factors look at issues, including how boards provide oversight for sustainability initiatives and evaluate their impact on the bottom line, how companies incent and compensate management based on those factors, and how they disclose ESG performance metrics to investors and the public. To borrow an old cliché that "what gets measured, gets managed," governance factors offer a means of validating company performance on sustainability issues. As

SRI's move into the mainstream gained coordinated global support in 2006, when the United Nations, in partnership with a group of the world's largest institutional investors, launched the Principles for Responsible Investment to promote a more sustainable global financial system. PRI signatories commit to invest their capital in accordance with six key principles. Today the PRI Initiative counts among its members nearly 1,400 firms, including Neuberger Berman, and accounts for approximately $60 trillion in assets under management.[2]

[1] US SIF Foundation, "Report on Sustainable and Responsible Investing Trends in the United States," 2014, http://www.ussif.org/trends.
[2] Source: Principles for Responsible Investment Initiative, as of April 2015.

Q&A WITH

Ingrid S. Dyott
Portfolio Manager, SRI Core Equity Team

❶ What explains the rapid growth in SRI assets?

From a wider industry perspective, the 2014 SIF Trends survey indicates that managers who incorporate ESG factors into their investment process cited client demand for fulfilling values and mission as the greatest motivator, followed by the desire to generate social benefits, minimize risks and seek financial returns.

From my perspective, there are three drivers. First, more mission-related investors have seen SRI strategies succeed and are investing in the space with history on their side. Second, with wider acceptance of ESG factors as material to performance, the category is attracting a broader investor base. Last but not least, long-term investors like foundations, endowments and pension funds are seeking ways to ensure the long-term financial health of their portfolios and increasingly are interested in sustainability issues.

part of their process, fundamental portfolio managers that consider ESG factors have a unique opportunity to engage with, and potentially influence, management teams and offer insight as they evaluate sustainability issues and their impact on shareholders. Other shareholder engagement tactics include shareholder resolutions and proxy voting.

Millennials and Women Leading the Charge

Meaningful growth in SRI during the last two decades underscores investor interest in the category. Between1995 and year-end 2013, SRI assets under management in the U.S. grew from $639 billion to more than $6.57 trillion, accounting for one out of every six dollars under professional management.[3] The same 2014 report identified 925 distinct funds that incorporate ESG criteria into the investment decision-making process, up from 55 in 1995.

While SRI has been traditionally associated with mission-based organizations, growing interest in ESG issues by the investing public at large, particularly among Millennials and women, may account for some of the gains in assets under management. Millennials may have fewer investable assets today than their more mature counterparts, but that is changing as they accumulate wealth through their own efforts and may become the beneficiaries of a portion of an estimated $30 trillion in wealth from Baby Boomers.[4] Both as consumers and investors, Millennials show a greater interest than the general public in working for, buying from and investing in companies that score well on sustainability factors. A 2015 Morgan Stanley survey of 800 individual investors with an oversample of 200 between the ages of 18 and 32, also found that Millennials are almost twice as likely to invest in companies or funds that target social or environmental outcomes, and are more than twice as likely to exit an investment due to objectionable corporate behavior.[5]

Women, meanwhile, are also demonstrating a strong interest in SRI strategies. In the 2013 edition of its annual Insights on Wealth and Worth Survey of 711 adults nationwide with investable assets of at least $3 million, U.S. Trust found that 65% of women feel it is important to consider the positive or negative social, political and/or environmental impact of the companies in which they invest, compared with 42% of men. In the same survey, 56% of women reported that they would be willing to trade some performance for investing in companies with a greater positive social impact, compared with 44% of men.[6] With women often joint voices or sole decision-makers in the management of household finances, their interest in ESG issues is likely to continue to be a factor in the growth of SRI strategies.

Performance Points the Way Forward

While sustainability factors do not measure financial performance, there is a growing body of evidence that these less-tangible issues can positively impact a company's profitability (see below). It follows that a company with engaged employees or one that manages resources efficiently may offer competitive advantages, with the potential to achieve better long-term financial performance, than a similar company that measures poorly on such sustainability issues.

The evidence supports this theory. Over a 15-year period, in aggregate, actively managed SRI equity funds in the U.S. outperformed their peer group and the S&P 500 on an absolute and risk-adjusted basis.[7] Research conducted by MSCI on two higher tracking error global strategies constructed using ESG data over an eight-year period also concluded that it was possible to improve returns on both an absolute and risk-adjusted basis by incorporating ESG factors into the investment process.[8]

[3] US SIF Foundation, "Report on Sustainable and Responsible Investing Trends in the United States,"2014, http://www.ussif.org/trends.

[4] Accenture, "The 'Greater' wealth transfer: Capitalizing on the intergenerational shift in wealth," 2012, https://www.accenture.com/us-en/insight-capitalizing-intergenerational-shift-wealth-capital-markets-summary.aspx.

[5] Morgan Stanley Institute for Sustainable Investing, "Sustainable Signals: The Individual Investor Perspective," February 2015.

[6] U.S. Trust, "Insights on Wealth and Worth," 2013.

[7] Source: Morningstar, Neuberger Berman, Forum for Sustainable and Responsible Investment.

[8] MSCI Research, "Can ESG Add Alpha", June 2015, https://www.msci.com/www/blog-posts/can-esg-add-alpha-/0182820893.

Further, a 2012 study by a trio of Harvard Business School professors using a matched sample of 180 U.S. companies found that high-sustainability companies—those that adopt rigorous sustainability policies such as giving the board of directors responsibility for sustainability, tying executive compensation to ESG metrics and auditing and disclosing this non-financial data—outperformed low-sustainability companies on measures of stock market and accounting performance.[9] A 2011 article in the Journal of Financial Economics found that companies with higher levels of employee satisfaction outperformed the market by 2% to 3% annually.[10]

ESG factors cover myriad issues—e.g., pollution, waste disposal, human rights, pay equity, quality of materials—that can impact a company's reputation and may affect the likelihood that it will face litigation. As a result, ESG factors are becoming a more integral component of the conversation about a company's quality. In determining its annual list of top-performing CEOs, Harvard Business Review validated this viewpoint in 2015 when it began evaluating ESG criteria alongside company performance metrics. Its methodology now weights ESG factors at 25% of a CEO's total performance score.[11]

Measuring the Sustainability Contribution

The growth of SRI appears on track to continue, particularly as Millennials gather and invest their assets, and institutional defined contribution and defined benefit plans further emphasize ESG factors following a favorable Department of Labor ruling in 2015 stating that ESG integration does not violate fiduciary duty.[12] As the category continues to evolve, the number of strategies available across asset classes—both actively and passively managed—is also likely to increase. While methods for companies to report on their sustainability efforts exist, however, they can be challenging to verify. We believe passion should not be passive, and that SRI is likely to be a category where active managers can distinguish themselves by employing fundamental research as they seek to identify companies that are differentiated on ESG and other factors that may be critical to performance.

SRI Equal Weighted Average: Consists of all U.S. actively managed socially responsible equity funds, as identified by Morningstar and the Forum for Sustainable and Responsible Investment, with a track record dating back to 2001.

Morningstar Large Blend Average: Morningstar Average is the average of all the funds in the Morningstar category. The Morningstar category identifies funds based on their actual investment style as measured by their underlying portfolio holdings (portfolio statistics and compositions over the last 3 years). This category was chosen for comparison purposes because the portfolio compositions of the funds in this category are similar to the composition of the fund over this period.

S&P 500: Consists of 500 stocks chosen for market size, liquidity, and industry group representation. It is a market value weighted index (stock price times number of shares outstanding), with each stock's weight in the Index proportionate to its market value. The "500" is one of the most widely used benchmarks of U.S. equity performance. As of September 16, 2005, S&P switched to a float-adjusted format, which weights only those shares that are available to investors, not all of a company's outstanding shares. The value of the index now reflects the value available in the public markets.

[9] Robert Eccles, Ioannis Ioannou, George Serafeim, Harvard Business School, "The Impact of Corporate Sustainability on Organizational Processes and Performance," 2012, http://www.hbs.edu/faculty/Publication%20Files/SSRN-id1964011_6791edac-7daa-4603-a220-4a0c6c7a3f7a.pdf.

[10] Alex Edmans, The Journal of Financial Economics, "Does the stock market fully value intangibles? Employee satisfaction and equity prices," 2011, vol. 101, issue 3, pages 621-640.

[11] Harvard Business Review, "The Best-Performing CEOs in the World," November 2015, https://hbr.org/2015/11/the-best-performing-ceos-in-the-world.

[12] U.S. Department of Labor, "Economically Targeted Investments (ETIs) and Investment Strategies that Consider Environmental, Social and Governance (ESG) Factors," October 22, 2015, http://www.dol.gov/ebsa/newsroom/fsetis.html.

Q&A *continued*

❷ How do you explain the appeal of SRI among women and Millennials?

Millennials witnessed the corporate scandals of the early 2000s and the 2008 financial crisis as young adults. As a result, they place a high value on ethics and responsibility. Meanwhile women, especially those in caregiving roles, are placing a higher priority on values and key sustainability criteria, recognizing that these characteristics can be drivers of good businesses over the long-term.

❸ What kinds of questions do you get from investors and how have they evolved in recent years?

We have seen SRI move from being defined by "what not to own" to being defined by "know what you own." While the NB SRI Core Equity team has always incorporated "leadership" criteria, we are enthused to see more investors interested in sustainability strategies as awareness has grown that ESG factors can be relevant to a company's business. Questions we get typically reflect ongoing environmental, employee and governance practices. They are also influenced by societal events like violence in schools, environmental disasters and human rights issues, typically in the supply chain.

ASSESSING THE VALUE OF THE ROTH IRA CONVERSION

Sharon Appelman, CFP®

The interplay among an intricate web of factors determines the strategy's potential value

A Roth IRA, in its basic form, is a tax-advantaged retirement savings vehicle for individuals and couples with incomes below a certain threshold. Those at the higher end of the income spectrum can also gain access via Roth IRA conversions, which can offer some wealth accumulation and estate planning benefits. The extent of these benefits can be tricky to evaluate, however, so a detailed analysis is warranted to determine whether the strategy is a good fit for your situation.

The immediate tax liability triggered by a Roth IRA conversion begs the question, why would anyone choose to pay taxes ahead of schedule?

In a Roth IRA conversion, you move assets from a traditional IRA (or employer-sponsored retirement account) to a Roth IRA via a distribution, which triggers an income-tax liability on pretax contributions as well as investment earnings on pre- and post-tax contributions to the original account. While income limits exist for contributions to Roth IRAs, individuals of all income levels can perform a conversion.

Why Convert from a Traditional IRA to a Roth IRA?[1]

In the decades since the Employee Retirement Income Security Act of 1974 ("ERISA") came into being, we've been incentivized to defer taxes for as long as possible through savings vehicles such as IRAs and 401(k)s. The immediate tax liability triggered by a Roth IRA conversion begs the question, why would anyone choose to pay taxes ahead of schedule? While counterintuitive, there are compelling reasons that you might choose to perform a Roth IRA conversion:

1. *No required minimum distributions (RMDs).* Traditional IRAs require that you start taking RMDs at age 70½. If you neither want nor need that income, converting to a Roth IRA will enable you to leave those assets in a Roth IRA account that can continue growing on a tax-exempt basis. Upon your death, your heirs will be subject to RMDs according to the rules applicable to inherited IRAs, but those distributions will also be tax-exempt.

2. *Reduce the size of your taxable estate (federal and/or state).* The taxes due upon conversion to a Roth IRA can be significant, so paying them will likely reduce the overall size of your taxable estate.

Conversion Candidates

The potential benefits of a Roth IRA conversion tend to be highest among a select group of people who meet certain criteria.

You want to leave a legacy

If you are unlikely to take distributions from your IRA and wish to pass the assets to a spouse, children or other individuals upon death, a Roth IRA conversion may be worth considering. By paying the tax upon

[1] While the article focuses on conversions from traditional to Roth IRAs, note that some employers now offer in-plan conversions from a traditional 401(k) to a Roth 401(k).

conversion, you effectively prepay the income tax for your beneficiaries and simultaneously reduce the size of your estate. As such, Roth IRAs can confer significant tax advantages to beneficiaries while also keeping the assets accessible should you need to draw on them during your lifetime.

You can pay the tax with a taxable side account

The ability to pay the taxes due upon conversion to a Roth IRA with taxable funds outside the Roth IRA is another compelling factor. If you do not have sufficient outside assets and pay the taxes out of the Roth IRA, then you decrease the amount of assets that can benefit from tax-exempt growth and distribution.

You can delay withdrawals

It's generally a good idea to avoid tapping into the funds in the Roth IRA for a minimum of five years following the conversion. While you can access your principal in the Roth IRA at any time, the tax-exempt status of growth and earnings kicks in after a five-year holding period.

You are at your lowest foreseeable tax rate

Due to the significant tax bill that goes with a Roth IRA conversion, it makes sense to perform one when your tax bracket is lower than it might be in future years. For some, this could be the period between the start of retirement and the triggering of RMDs. However, even absent this circumstance, the conversion can still make sense. Remember that, while you pay income taxes on the conversion up front, in not having to take the RMDs later you may lower your future annual tax bill.

Other Considerations

All things being equal, and assuming your tax rate remains stable throughout your life, it should not matter whether or not you convert. You either pay taxes earlier (upon conversion) or later (when you take RMDs). It's simply a question of the timing of the payment of taxes. However, there are other factors to consider.

Gradual Erosion of the Taxable Side Account

Putting aside for a moment the variability of your effective tax rate from one year to the next, the difference between converting and not converting plays out in the gradual erosion of your taxable side account—the one that would be depleted to pay the tax upon conversion. When you perform a conversion and pay the resulting tax with assets from a taxable account, the full value of the retirement assets remains in the Roth IRA to grow tax-exempt. Conversely, if you do not perform the conversion, the amount you would have withdrawn from the taxable account remains in that account, where it continues to grow but will be subject to taxes on interest and dividends (and perhaps capital gains) each year. All things being equal, and assuming the assets were invested in a comparable allocation in both scenarios, you might expect the value of the Roth IRA in the distant future to be higher than the sum of the after-tax value of the traditional IRA and the taxable side account.

Income in Respect of a Decedent (IRD)

If you have a federally taxable estate that includes traditional IRA assets, there is an additional consideration: Your heirs may be entitled to an IRD tax deduction. The IRD deduction is an attempt to account for the fact that, otherwise, your heirs would pay income taxes on assets that have already been assessed with the estate tax—

Roth IRAs can confer significant tax advantages to beneficiaries while also keeping the assets accessible should you need to draw on them during your lifetime.

which may be thought of as a form of double taxation. The deduction does not apply to beneficiaries inheriting a Roth IRA from a decedent with a taxable estate, as the Roth IRA income is not taxable upon distribution.

(If you have inherited an IRA that may be eligible for the IRD tax deduction, consult with your tax accountant or the trust and estate attorney who handled the estate. In the event that you are eligible for the IRD deduction, you would need to remember to claim it each year on your tax return.)

Timing the Conversion

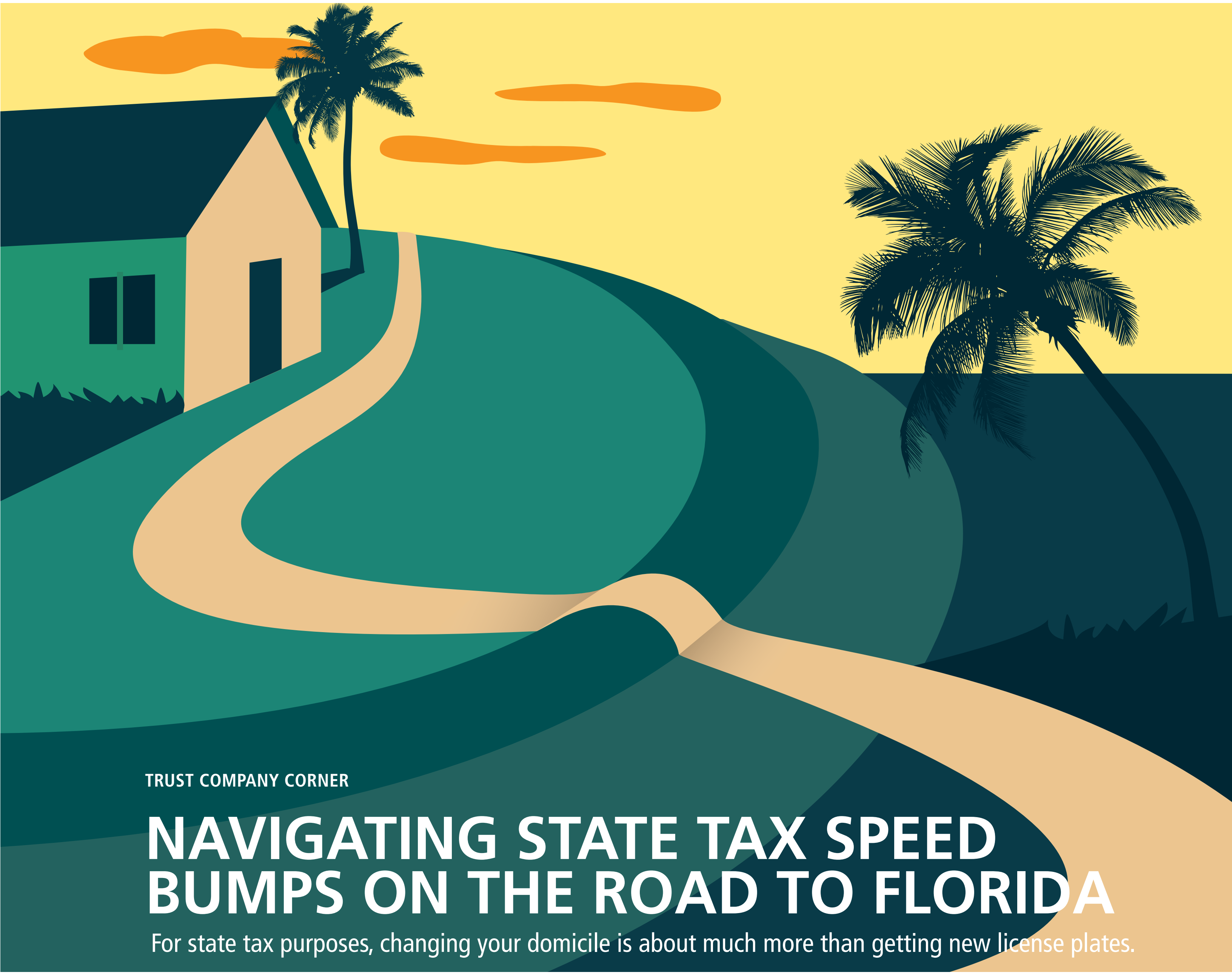
You may convert the entire IRA in one year, or spread the conversion over multiple years. A detailed examination of the advantages and disadvantages of each approach can be performed with your financial advisor or tax professional. The analysis should not focus exclusively on the regular federal marginal tax brackets, but should also take into account the potential impact of the alternative minimum tax.

If you convert to a Roth IRA and then the value of the account declines substantially, you have the option to "re-characterize" your Roth IRA back to a traditional IRA. You would receive a refund on the tax paid on the conversion and, if you chose, could reconvert to a Roth IRA with a potentially lower tax liability based on the reduced value of the account.[2]

The success of a Roth IRA conversion will depend on a complex interplay of myriad factors including current and future tax rates, income requirements, investment performance, longevity and personal financial goals. For many people, the difference may be small or nonexistent. In some cases, the conversion could result in a loss—for example, if you need to withdraw assets soon after the conversion or your future tax rate drops sharply. Generally, the conversion tends to be most compelling when considered from the perspective of estate planning. Working with a financial advisor to assess your situation and the potential outcomes of a Roth IRA conversion can help you determine whether it is a feasible option for you.

The success of a Roth IRA conversion will depend on a complex interplay of myriad factors, including current and future tax rates, income requirements, investment performance, longevity and personal financial goals.

[2] Before recharacterizing or reconverting IRA/Roth IRA assets, it is important to familiarize yourself with the rules and restrictions regarding the timing and frequency of these transactions.



TRUST COMPANY CORNER

NAVIGATING STATE TAX SPEED BUMPS ON THE ROAD TO FLORIDA

For state tax purposes, changing your domicile is about much more than getting new license plates.

Diane E. Lederman, President and Chief Executive Officer, Neuberger Berman Trust Company N.A.

Each fall, Northeasterners head south to Florida, seeking to escape winter's chill as well as hefty tax bills from states like New York and New Jersey. Indeed, Florida's attractive tax laws—which levy no state income or estate tax on individuals—draw many retirees looking to preserve wealth. While the financial benefits of establishing domicile in Florida can be significant, mitigating the tax bill from your state of origin can be challenging. To make a compelling case to the tax authority, each action you take should reflect your intention of making Florida your new home.

High income and estate tax states such as New York are loathe to see potential revenue migrate out of state. They can be diligent in their pursuit of former residents, particularly those that maintain ties there. When it comes to determining domicile, the crux of the issue is whether you moved to a new state with a sincere intention of making it your permanent home. Changing your voter registration, driver's license, vehicle registrations and billing addresses are steps in the right direction of establishing a new domicile (see Checking the Boxes: Tips for Establishing Florida Domicile), but they are secondary to deeper issues that get to the heart of your intent to establish a new home base. To mitigate incurring a tax liability from your state of origin, it is helpful to be mindful of the following factors, which are often considered when verifying your domicile change. It is important to note that the below factors are a merely a guide on how tax authorities have viewed issues relating to domicile and it is very likely that the relevant state tax authorities could focus on one factor more than another.

1. Time on the Ground

You may establish a residence and spend significant time in Florida, but if you spend more than half the year—or 183 days—in a different state, such as New York or New Jersey, and maintain a home there, you can be considered a resident for tax purposes. It is important to note that, with a few exceptions, partial days in the state count as full days toward your total. In the event you are asked to verify your whereabouts on certain days, it can be advantageous to maintain a log of the dates that you are in each state, and be prepared to furnish flight reservations, cell phone bills, gas station receipts, credit card receipts and other records.

Special Considerations for New York State Property Holders

If you are domiciled in Florida and own property in New York State, under certain circumstances your heirs may be subject to New York estate tax. New York estate tax applies to "real" or "tangible" personal property held in the state by nonresidents, as well as to certain gifts made after April 1, 2014, while a New York resident. While a house and a condominium apartment qualify as real property and are subject to New York estate tax, a cooperative apartment is considered "intangible" property and would not be subject to New York estate tax. If the value of your New York real and tangible personal property (and applicable gift addbacks) exceeds New York's exemption amount (currently, $4,187,500), a New York estate tax may be due. There may be ways to mitigate the potential estate tax burden on your heirs of owning New York property if you plan in advance. Speak to a tax or estate planning professional to discuss your situation in depth.

2. Maintaining a Florida Residence

Owning or renting a home in Florida can help establish domicile, but maintaining a "permanent" home in your previous state of residence generally triggers the 183-day rule referenced above and can be a red flag for the tax authority. It is helpful if the residence you maintain in your former state is smaller in size than your Florida home. It is also important to show that you have "abandoned" the home in your former state for your new residence in Florida. Moving furnishings, artwork, family heirlooms and other cherished possessions, such as family photos or collections, to your Florida residence is one way to demonstrate abandonment. It can be useful to keep documentation from the move, whether it is an itemized receipt from a moving company or insurance purchased to cover the items during the move, to demonstrate your intent to make Florida your permanent home. Further, making subsequent large purchases—cars, boats, artwork—in Florida may also lend credence to your domicile claims. When making travel arrangements, leaving from and returning to Florida can demonstrate that you have made it your permanent home.

3. Business Activities

Continuing to work in your former state, whether it is as an employee or as a business owner, can jeopardize your change of domicile. There are no hard and fast rules to follow, and the tax authority has some leeway in determining if there was an intent to change your domicile. For example, if you move to Florida but keep your job in New York and travel there frequently to work in your company's office, even if you are not in New York often enough to trigger the 183-day rule mentioned earlier, New York State may consider you a resident for tax purposes. If you own a business, selling it may be the simplest solution, but it may not be realistic and is not required. Demonstrating a passive interest by ceding control, extricating yourself from day-to-day operations and lowering your salary can be helpful.

4. Family Ties and Community Involvement

Many times, people will replace a family home in their original state with a smaller home there, then purchase a primary residence in Florida. If you maintain ties to a community in your former state, however, whether your children and grandchildren continue to live there or you see friends or attend religious services when you are in town, the state tax authority may question whether you have truly "abandoned" the state. Cutting ties, where possible, from groups in your old state (for example, canceling club memberships and resigning from positions in the community) and cementing new relationships that demonstrate that you are engrained in your Florida community could be helpful. Examples can include joining a country club, establishing ties to a religious institution and attending services there, becoming an active member of a neighborhood association, performing charity work or joining and attending a gym. Hosting family gatherings in Florida whenever possible can also help solidify your case.

States such as New York can be aggressive in their pursuit of former residents. To help establish your Florida domicile, there are a few hard-and-fast "must-dos" and a long list of smaller "should-dos." Remember that it's not just about moving to Florida, it's about establishing it as your new home. Because there's an element of judgment involved in determining domicile, it's important to do what you can to create a compelling picture of your new life as a Floridian for the benefit of the state tax authority.

[1] This partial list offers a sampling of actions that you may pursue in establishing Florida domicile. It is not exhaustive, and completing all items on the list will not guarantee a successful domicile change.

CHECKING THE BOXES: TIPS FOR ESTABLISHING FLORIDA DOMICILE[1]

- ☑ File a Declaration of Domicile in Florida if you maintain residences in two states, and file it with the tax authority in your former state
- ☑ Apply for a Florida driver's license and surrender license issued by your former state
- ☑ Title and register vehicles in Florida
- ☑ Register to vote (and vote) in Florida, and have your name stricken from the voter rolls in your former state
- ☑ Apply for the Florida Homestead exemption (if you own a home)
- ☑ File federal taxes in Florida using your Florida address
- ☑ Change your address of record on all credit cards to Florida and receive all bills in Florida
- ☑ Move safety deposit boxes to Florida
- ☑ Change accountants and lawyers and update estate planning documents to reflect Florida residency, including executing Florida advanced directive, living will, designation of health care surrogate, nomination of pre-need guardian and power of attorney; execute documents in Florida
- ☑ Transfer accounts to Florida institutions
- ☑ Have Social Security checks deposited in Florida bank accounts
- ☑ Notify insurance carriers that your new domicile is Florida
- ☑ Change doctors and forward medical records to new Florida medical professionals

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