IQ

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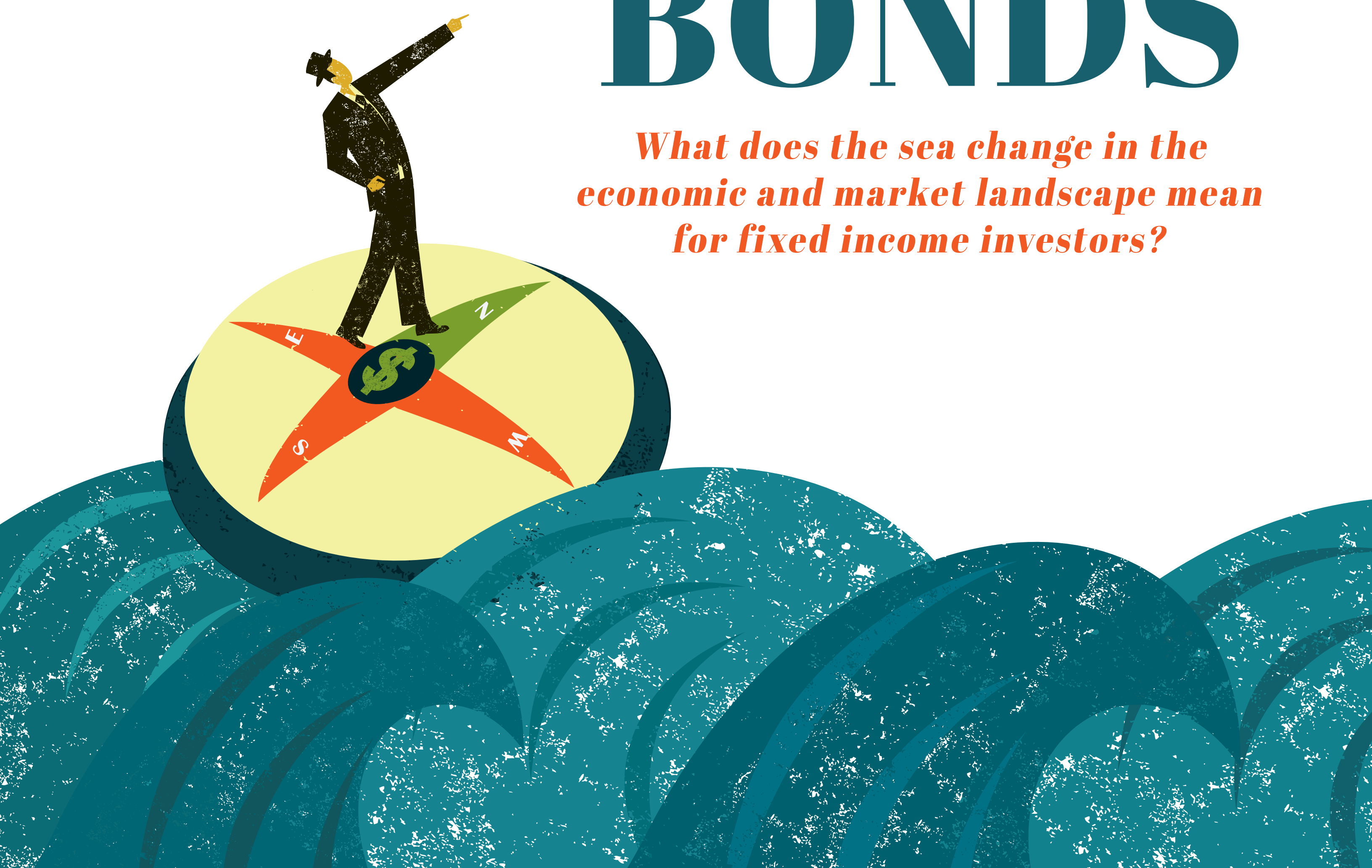
IN THIS ISSUE:

A 'NEW' WORLD FOR BONDS

What does the sea change in the economic and market landscape mean for fixed income investors?



IN THIS ISSUE

John F. Geer, Jr., Managing Editor

ADAPTING TO A NEW REALITY

From time to time, events occur that fundamentally alter the context in which investors make decisions. For a while, U.S. market sentiment was chronically lukewarm—kept afloat by ultra-loose monetary policy and plodding economic gains, but frequently threatened by stagnation in Europe, slow earnings and the decay of the commodity complex. Late in 2016, a combination of improving economic numbers and the surprise election of Donald Trump became an accelerant for risk assets, as investors anticipated supportive impacts of tax reform and reduced regulation.

The New Year has brought with it predictable complications—noise over cabinet posts, questions about policy details, plus the realization that promised changes will take time and effort to implement. Even with a smooth process, tax reform may not actually take effect until 2018, while the anticipated infrastructure "surge" could take years to pay dividends. On balance, we are favorably disposed to U.S. equities, but we could also anticipate that "perfectly priced" markets may grow impatient with current progress.

With this backdrop, the current issue of *Investment Quarterly* offers insights tied to the theme of transition: the "new" world faced by fixed income investors, bullish fundamentals in the energy sector, and "Ten for 2017" ideas that could inform market behavior for the balance of the year. Rounding out our topics, we consider important nontax reasons for estate planning, and strategies for dealing with single-stock portfolio concentration.

We hope you enjoy *IQ*. Please contact your Neuberger Berman representative with questions about the markets or your portfolio.

Joseph V. Amato
President and Chief Investment Officer—Equities

HIGHLIGHTS 1Q17
FROM THE ASSET ALLOCATION COMMITTEE

U.S. equities: With the election result and its presumed pro-growth, reflationary implications, we shifted our bias toward U.S. equities and away from non-U.S. assets.

U.S. fixed income: On expectations of higher interest rates, we had reduced our outlook for a number of domestic investment grade fixed income sectors. But with some backup in yields, we moderated that outlook to slightly below normal.

High yield and TIPS: We continue to have a neutral view on high yield debt and Treasury Inflation-Protected Securities, preferring them to other fixed income alternatives.

Commodities: The recent agreement by OPEC and some non-OPEC nations to curb production will likely support oil prices. We have a slight overweight view on commodities.

Emerging markets: The potential negative impact of a strong dollar and rising rates, as well as uncertainties around Trump administration policies, prompted us to downgrade EM equities to a slight underweight and maintain that view on EM debt.

Hedge funds: Potential for increased volatility and greater dispersion of stock performance could benefit active managers in general and long-short strategies in particular. We have a slight overweight view of lower volatility and directional hedged strategies.

A 'NEW' WORLD FOR BONDS

What does the sea change in the economic and market landscape mean for fixed income investors?

Brad Tank, Chief Investment Officer - Fixed Income

The U.S. presidential election was a transformative event. It focused tired markets on the potential for tax reform and reduced regulation, which introduced new optimism about economic growth, corporate earnings and a shift from ultra-low inflation. This has contributed to a surge in equities, and a tightening of spreads on corporate bonds, particularly in high yield, while Treasury yields have seen a sharp increase (and commensurate decline in Treasury prices).

This is in stark contrast to the pessimism that reigned for the previous two years, when investors were preoccupied with slow growth and what seemed like the stuttering end to a very long business cycle. Flat corporate earnings, the drop of oil prices and the related six-quarter correction in high yield energy assets contributed to the malaise. As recently as the first quarter of 2016, meager U.S. economic growth and uncertain prospects in China were ongoing worries.

The nadir of sentiment came in July 2016, at a time when central banks were flirting with the "dark side" of negative policy rates and seeing the limits of extraordinary monetary intervention. From there, yields began to inch up and risk assets gained momentum. The election then accelerated those trends. Interestingly, if you look at where rates are today versus the start of 2016, the trend is less dramatic.

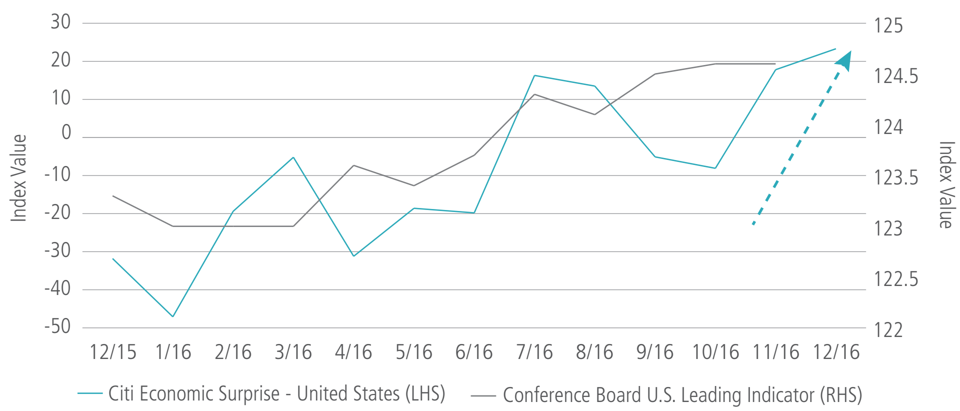
It's possible that investors have exaggerated the potential economic upside from the change in political regimes, but there are certainly significant shifts in the works.

Anticipating Meaningful Change

It's possible that investors have exaggerated the potential economic upside from the change in political regimes, but there are certainly significant shifts in the works. Of primary importance is the rewriting of the tax code. House Republicans introduced a framework for corporate and personal income tax reductions back in June. At the time, it was given little chance of success, but given Trump's campaign promises and Republican control of the executive and legislative branches, reform seems likely, with possible passage in the second or third quarter and implementation in January 2018.

Its impact, by many accounts, would be significant. Corporate tax cuts alone have been estimated to increase corporate profitability by 10%, while a portion of personal tax savings is likely to enter the consumer economy. Depending on its size, an infrastructure package could help stimulate growth in the mid- to long term, while reduced regulation could encourage business expansion down the road.

ANTICIPATION HAS HELPED TO DRIVE MARKETS



Source: Bloomberg.

All told, we anticipate GDP growth moving from around 2% in 2016 to roughly 2.5% in 2017, with possibly higher growth in 2018 depending on the success of tax reform and other initiatives I've mentioned.

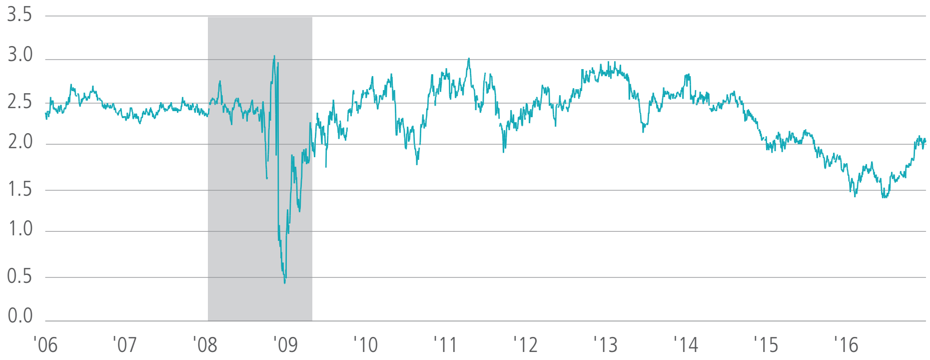
Steady Rate Hikes, a Tougher Environment

As for interest rates, the Federal Reserve has hesitated to tighten for some time, but optimism about growth and inflation seems to now provide "air cover" to hike rates in a more sustained way. After its December increase, the central bank anticipates raising the fed funds target three times in 2017, to 1.25% – 1.50% by year-end, and could become more hawkish after that if inflation inches above its 2% target, as some expect. Still, its approach remains gradual and data-driven, as the risks of overtightening at this point outweigh those of further accommodation.

What does this do to fixed income prospects for the year? It clearly makes things more challenging, particularly for rate-sensitive Treasuries. We believe that the 10-year Treasury yield will rise to about 3.0% this year from its recent 2.4%. The story is more positive for corporate bonds and other credits. Economic firming and better yields are likely to extend expectations for the length of the credit cycle, which should help to further tighten yield spreads over Treasuries. All else equal, the after-tax yields of municipal bonds

INFLATION IS REBOUNDING BUT STILL BELOW TARGET

5-Year, 5-Year Forward Inflation Expectation Rate (%)



Source: FRED, Federal Reserve Bank of St. Louis. Recession Years: December 2007 to June 2009. Data through December 31, 2016.

would be reduced by tax cuts, but the sector is already cheap relative to other quality bond segments. Overall, we believe it will be important for investors to be flexible in their approach to bonds, to better capitalize on the opportunities beyond the broad indices (See "Fixed Income's Role" on page 4). That said, the low global rate picture may limit the extent to which U.S. nominal rates rise this year, as foreign investor flows could rush in to capitalize on differences with home country yields.

Breaking the Logjam

It may seem strange to hear from a fixed income manager, but I believe that this move to higher rates is actually very positive in the long term. The fact is that the major economies in developed markets have, in my view, reached the limits of nonconventional monetary policy. There's only so much they can do to fight deflation and stimulate growth. Help has to come from other branches of the government through fiscal stimulus, whether tax cuts, reduced regulation or spending, or a combination of all three.

Until now, the Fed has missed opportunities to raise rates and normalize the yield curve because of ongoing concerns about growth. Whether you like the new administration or not, its pro-growth bias lays the groundwork for expansion that doesn't rely on ultra-low rates and a flat yield curve that have penalized savers and encouraged speculative, non-economic business activity. There are clearly risks: If the tough anti-globalization rhetoric of the campaign translates into trade war, that could offset any benefits from tax reform or deregulation. However, I believe that the Trump administration will probably take a more pragmatic approach, akin to the Reagan administration's assertive negotiations with Germany and Japan 30 years ago. Another less dramatic risk is that the consumer may decide to "take a couple quarters off" due to uncertainty over health care coverage and other worries; that's not our base case, but it could slow the expansion and cause the Fed to be more cautious.

Net-net, I believe recent events have likely broken the logjam on rates. That's not only good for the long-term health of the economy, but it also will likely recharge the Fed in the future when it once again needs to confront economic weakness or even crisis. Investors have experienced tightening cycles before, but this one is "new" given the low yield levels we will be emerging from. Although the process will likely create some near-term pain for fixed income investors, I believe it also sets the groundwork for a more normal environment and healthier prospects for savers over the course of time.

It may seem strange to hear from a fixed income manager, but I believe that this move to higher rates is actually very positive in the long term.

FIXED INCOME'S ROLE AND THE VALUE OF FLEXIBILITY

A low interest rate environment creates inherent challenges for fixed income investors. For those with near-term spending needs, rate increases and corresponding declines in fixed income portfolio value can undermine individual objectives. With that in mind, it's important to have a broad perspective: to understand what you seek to achieve with bonds and get the most out of your holdings.

Portfolio Diversifier. Fixed income has historically been used in an effort to improve portfolio stability and provide diversification from equities and other riskier market segments of a portfolio. In the current environment, bond valuations may take a haircut with higher rates, but for those with a diversified portfolio, this may be offset by other assets like equities as we saw in the second half of 2016. Should equity markets falter, the distinct characteristics of bonds could help them mitigate declines in value from weakening equities.

Income Benefits. Because of aggressive monetary policy, bonds haven't been particularly good at providing income in recent years. Often investors have stretched to riskier assets to make up the shortfall. With a sustained rise in rates, the purchase of new bonds should provide higher yields that, over time, can potentially lessen or even eliminate the losses tied to market declines on existing holdings. They could also nullify the penalty that savers have endured since the financial crisis from meager investment incomes.

Looking Past Benchmarks. Leaving aside that longer-term positive, the fact is that you have to tend to your portfolio today—which is a puzzle given current rate trends. Many bond managers run portfolios that look very much like major bond indices. This approach was a benefit over the 30-year decline in interest rates, but is much less defensible now that the free ride is likely over. The Bloomberg Barclays U.S. Aggregate Bond Index, for example, has a heavy weighting of low-yielding longer-term sovereign debt, which is particularly sensitive to interest rate fluctuations. In our view, looking beyond such benchmarks to establish fixed income exposure could be a key to reducing risk and introducing opportunity.

Portfolio Flexibility. The idea of "off-benchmark" investments is tied to another key concept: flexibility. Relationships among assets are changing. Two years ago, for example, there was tremendous pessimism about high yield bonds while government prices were going up. But in 2016, the relationship reversed amid higher rate expectations (hurting Treasuries) and optimism about the business cycle and oil patch (helping high yield on a relative basis). In view of such shifts, it's important to have the ability to move across asset classes and sectors. Investment grade corporates, high yield, mortgages, emerging markets debt, Treasuries and TIPS all have varying characteristics and fundamentals, and their relative attractiveness will change over time. At the same time, when investing across markets and geographies, we believe experience as well as broad expertise are key to gauging risk and capitalizing on global fixed income opportunities.

DEALING WITH CONCENTRATED STOCK POSITIONS

Sharon Appelman, CFP®, Director of Financial Planning

A single stock may have generated much of your wealth, but also poses risks that should be addressed.

Concentrated stock positions can be the source of considerable wealth creation. Executives who own or run companies are often rewarded with company stock or stock options, and their personal success is typically intertwined with that of the business. As is so often the case, however, this success does not come without its drawbacks. When that wealth is achieved, it is by definition highly concentrated and thus particularly vulnerable to downside risk. A key question for many investors becomes: what can they do about it?

Concentration is somewhat of a moving target for financial professionals. For many, a position is considered concentrated when it makes up more than 5% of an investor's liquid portfolio. However, the threshold may be higher (10% or 15% perhaps) if the concentration comes from two or three similar securities.

The implications of the concentration may also vary. For example, it could be that the investor's future financial success is highly dependent on the long-term stability of the underlying stock price. Conversely, a concentrated position might constitute only a component of a family's assets, making their issue more one of wealth transfer and legacy. An executive with a concentrated position may be constrained in terms of how much of the stock can be sold at any given moment. Moreover, her risk may be exponential—if the company fails, she not only loses her investment, but her job, too. By the same token, she may be relatively comfortable with a higher degree of concentration than normal, and feel compelled to hold onto shares out of loyalty, or a perception thereof. In contrast, family members with undue concentration may have no such bond and be more concerned about achieving diversification. In many cases, taxes will be a key issue, as concentrated positions often carry a low cost basis.

Regardless of personal situation, a concentrated position should not be met with complacency. History is littered with once-prominent companies that took a turn for the worse. This includes not only notorious failures such as Enron or WorldCom, but also companies with strategic flaws (AOL Time Warner), difficult fundamental environments (the energy sector in 2015) or whose overvalued stocks simply fell back to earth (the '70s "Nifty 50"). Leaving aside such examples, even prosperous single stocks tend to be very volatile compared to diversified portfolios, presenting a challenge for investors looking for a smoother ride.

Depending on the situation, the approaches to dealing with concentration risk may vary, but the basic building-block strategies are fairly consistent.

The approaches to dealing with concentration risk may vary, but the basic building-block strategies are fairly consistent.

Basic Approaches

Sell the stock. Sometimes the simplest choice is the right one. A stock position may simply be too large a percentage of your overall net worth, or you may have a significant liquidity need. Obviously, selling all or a large portion of the stock position can come with a significant tax cost, given the current top capital gains tax rate of 20% (or 23.8% including the surcharge on investment income for high earners). Sometimes investors choose to sell gradually, for example over two or three years. This extends the period of exposure, but also is a way to spread out the realization and payment of taxes and dollar-cost-average out of the position.

It's essential to put in place a plan that accounts for the concentrated position in the context of your specific situation.

Build a completion portfolio. If you are unable or unwilling to sell a position, it may be prudent to avoid compounding your exposure with securities that may duplicate your risk. If your stock is in a large U.S. health care company, for example, you may consider otherwise underweighting that sector and large caps in general.

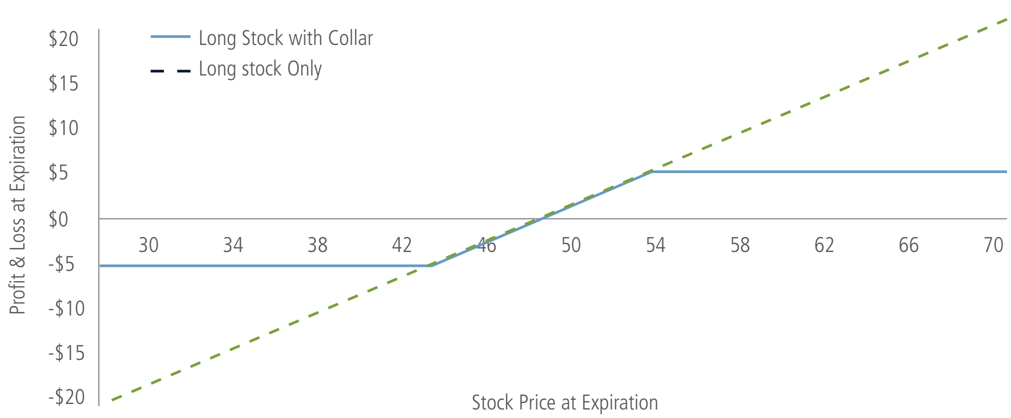
Options and Forwards

Buy a put. This strategy gives you the right to sell your stock at a given exercise price (typically lower than the current market price), providing you with downside protection. It can be an expensive approach, and thus may only be an option for use on a temporary basis (for example, if you are selling in stages, as referenced above).

Create a 'zero-cost' collar. Here you buy the protective put, but finance it with the sale of a call on the same stock. The call gives someone else the right to buy the stock at a particular price, usually above market value. If the stock stays between the call and put option prices, nothing happens. If it moves above that range, the stock would likely be called and you would then have to sell. If it slips below it, you have the option to sell. Essentially, you limit your upside in exchange for some downside protection at a lower cost.

Hypothetical: Equity Position with 'Zero-Cost' Collar

- Investor owns shares with current market price of $50
- Purchases six-month put option with strike price of $45 (10% below)
- Sells six-month call option with a strike price of $55 (10% above)
- Premium from call offsets cost of put



For illustrative purposes only.

Write a covered call. This technique is less about downside protection than income generation. By repeating the process over time, you are able to create an income stream from a position that you might otherwise prefer to sell, and partially offset potential declines. However, with a covered call, both downside protection and upside are limited.

Prepaid variable forwards can help liquefy a position while deferring a sale for tax purposes. These forward contracts provide the investor with an upfront payment of generally 75 – 90% of the shares' current value against their delivery at a later date. The forwards offer protection from a drop in the stock price below an agreed "floor" price while allowing participation in the upside up to a higher price, or "cap." If desired, you can use the proceeds to invest in a diversified portfolio.

Other Approaches

Exchange funds allow you to pool your concentrated stock in a fund with other investors' stocks, thus creating a more diversified portfolio, which is run by a professional manager. Once the fund reaches its target size and portfolio composition, it closes and each investor receives a pro-rata share, which can be redeemed after a set period without penalty (usually seven years). The technique helps to dampen your concentration risk while deferring a tax event. It is important to note that at least 20% of the exchange fund must be held in illiquid investments, which may require you to contribute cash in addition to your stock.[1]

Rule 10b5-1 trading plans. Corporate insiders can prearrange the sale of stocks under carefully outlined conditions, regardless of whether the sales take place during a blackout or other restricted period. Such plans, which must be adopted at a time when the insider is not in possession of material, nonpublic information, provide liquidity as well as an affirmative defense against allegations of insider trading, and a potential reduction in market impact from an insider sale.

Estate Planning and Concentrated Stock

Beyond these strategies, it can be important to integrate the stock into your estate planning. Concentrated stock positions often carry a low cost basis for tax purposes, which may inhibit your inclination to sell. However, at death current U.S. tax law provides that stock held in your name receives a step-up in basis, which can reduce or eliminate the capital gains tax upon sale. This means that, depending on your age and other circumstances, the benefits of holding onto that stock may outweigh the risks. As such, certain value preservation approaches noted above, like a zero-cost collar, may be considered to bridge that gap.

Assuming you are charitably inclined, donating appreciated stock can be highly tax-efficient, as you can generally take a deduction for the stock's full market value (up to 50% or 30% of AGI depending on the type of organization receiving the donation) regardless of the cost basis. Another popular technique is to donate the shares to a charitable remainder trust (CRT). The CRT sells the stock and reinvests in a portfolio of diversified or income-producing assets, which is designed to provide you with regular distributions for a set period of time or until death, and leave the charity with the remainder. You receive an immediate tax deduction for the value of the remainder interest, subject to restrictions based on your adjusted gross income (AGI). If your deduction in year one is limited due to your AGI, you can carry over the excess into future years, for a period not to exceed five years. Depending on your goals, a low interest rate environment may be less conducive to this strategy.

Customization Is Key

Investors come to concentration from multiple routes, whether through executive compensation, inheritance or portfolio strategy. Moreover, their personal circumstances may be quite different. Some may depend heavily on the value of the position, while others may be more motivated by legacy issues. It's essential to put in place a plan that accounts for the concentrated position in the context of your specific situation, to increase the likelihood that you achieve your objectives.

[1] In addition, an investment in an exchange fund is usually subject to a one-time upfront fee and an annual client fee. Exchange funds may have restrictions relating to the contributed stock, minimum investment requirements and investor eligibility requirements.

SOLVING FOR 2017

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Ten for 2017

Investors have been recalibrating their portfolio views given tectonic shifts in Washington, DC, and the markets, with new optimism on the domestic economy and equities but wariness on sovereign fixed income. In this unsettled environment, the heads of Neuberger Berman's four investment platforms recently identified the key themes they anticipate will guide investment decisions in 2017.

MACRO: A SEA CHANGE FOR ECONOMIES AND MARKETS

1 **The Rise of Nationalistic Self-Interest Continues to Upset the World Order**

After political upheavals in the U.K. and U.S. during 2016, French and German voters will be among those in 2017 to test the persistence of anti-establishment/anti-globalization trends.

2 **Central Bank Impact Fades**

Global central banks appear to have reached an inflection point and will likely drive an increase in interest rates, inflation expectations and market volatility, and a stronger U.S. dollar.

FIXED INCOME: NORMALIZATION RESUMES

3 **Real Interest Rates in the U.S. Continue to Push Higher**

Expectations for higher growth and inflation are likely to drive higher Treasury yields and a steeper curve, though we don't anticipate a break from the global rate tether.

4 **Credit Still Holds Appeal**

The credit cycle is mature, but it doesn't appear ready to turn just yet; when it does, more supportive fundamentals are likely to help absorb the impact.

EQUITIES: BACK TO BASICS

5

Pro-Growth Trump Administration Fuels Outperformance of U.S. Equities

A more business-friendly environment—characterized by lower taxes, loosened regulations and robust fiscal spending—could provide a tailwind for corporate earnings and stock markets in the U.S.

6

Alpha—And Active Managers Able to Generate It—May Stage a Comeback

The removal of artificially low interest rates could result in individual stock performance once again being differentiated by company fundamentals, to the benefit of high-conviction, fundamental investors.

EMERGING MARKETS: BOTH WINNERS AND LOSERS EMERGE

7

Economic Orientation Counts

In our view, fears that U.S. policy will drag down the entire emerging world are overblown; improved global growth should be generally supportive, though countries likely will be differentiated based on their key economic drivers—manufacturing vs. commodities vs. domestic.

8

China Risks Remain Significant

The world's second-largest economy faces a number of ongoing issues—from asset bubbles to currency management—that require a particularly deft touch from Beijing.

ALTERNATIVES: HELPING NARROW THE RETURN GAP

9

Volatility Can Work for Investors

We anticipate that the difference between long-term investor needs and what can be generated from traditional sources of beta is likely to persist, highlighting the value of alternative risk premia and volatility-capture strategies.

10

Private Debt Remains Attractive

Despite the potential re-emergence of banks as liquidity providers, it is unlikely that they will rebuild the infrastructure required to compete in similar, less-liquid credit. In addition, increased M&A activity will likely keep the private debt market well stocked with opportunities.

For more details, read the CIO Roundtable in Neuberger Berman's *Solving for 2017* annual outlook, at www.nb.com/Solving2017.

Please see the disclosures at the end of this publication, which are an important part of this article.

Where Will the European Election Cycle Lead?

The developed world is currently experiencing a surge in anti-establishment, populist sentiment. It began with Brexit in June, before moving to the U.S. and Donald Trump's presidential win in November. Italy's referendum on constitutional reform came next, with a negative vote triggering the resignation of then-Prime Minister Matteo Renzi. Although the particulars vary by region, these results fit a standard narrative: that disaffected constituencies feel left behind by globalization, damaged by stagnant economies post the financial crisis, and culturally threatened by open borders, and are therefore looking to use their votes to disrupt the status quo.

As disruptive as it was in 2016, the cycle could create even more fireworks this year, with several key elections looming in Europe:

The Netherlands, March 15. The far-right Party for Freedom (PVV) has been polling well with anti-Islam, anti-immigrant policies. Leader Geert Wilders has pledged to hold a vote on Eurozone membership should he take office, although the practicalities of doing so under current Dutch law would be extremely difficult. Moreover, other Dutch parties may try to form a coalition government that keeps the PVV out of power.

France, April 23 and May 7. Marine Le Pen, leader of France's Nationalist Front, seems likely to be one of two candidates to win the initial round of France's presidential election and move into a runoff in May. The far-right candidate has been vocal on immigration, terrorism and the European Union. Full victory has been seen as unlikely, but incumbent socialist Francois Holland's decision not to run has put the race in flux.

Germany, October 22. Three-term incumbent Chancellor Angela Merkel is closely identified with an assertive European Union, having pushed for austerity measures post-financial crisis and okayed the influx of more than a million refugees into Germany. At this point, her center-right Christian Democratic Party is expected to lose some seats in the legislature but still come out ahead, although the attack on a Berlin Christmas market this December will not have helped her cause. The right-wing player in this case is the Alternative for Germany Party, which has a small minority of votes, but could see increased influence depending on the election result.

For investors, politics don't necessarily translate into fundamentals, or by extension to markets or securities prices. Still, these contests (along with a possible election in Italy[1]) bear watching as nations grapple with key economic and social issues, and how they will be addressed.

[1]Italy's next national election is scheduled for 2018, but with Renzi's resignation, President Sergio Matarella could call for a vote this year.

ENERGY FROM POLITICS TO THE PERMIAN

Todd Heltman, Jeff Wyll and Ronald Silvestri, Senior Analysts, Global Equity Research

THE NEW ADMINISTRATION WILL LIKELY HAVE AN IMPACT, BUT WE BELIEVE THE KEY DRIVER FOR U.S. ENERGY COMPANIES IS IMPROVING FUNDAMENTALS.

This past fall saw major shifts in the backdrop for the energy sector. Donald Trump was elected U.S. president with campaign themes including energy independence and reduced regulation, while OPEC (and some non-OPEC producers) agreed to cut production—the first such deal from OPEC since 2008. After an initial after-hours swoon, the election prompted a sharp relief rally among many of the sectors perceived as overregulated, of which energy is arguably one. The OPEC announcement later bolstered oil prices and reignited the energy rally, leaving the sector with a gain of 11% from November 4 through the end of the year.[1]

The question is, what comes next? To what degree will the Trump administration make a difference to energy companies? By the same token, what do we make of the sector in the midst of the seemingly bullish producer coordination and renewed oil price momentum? We explore these dynamics below, looking at supply/demand fundamentals before tackling the potential "Trump effect."

Unleashing the 'Shale Beast'

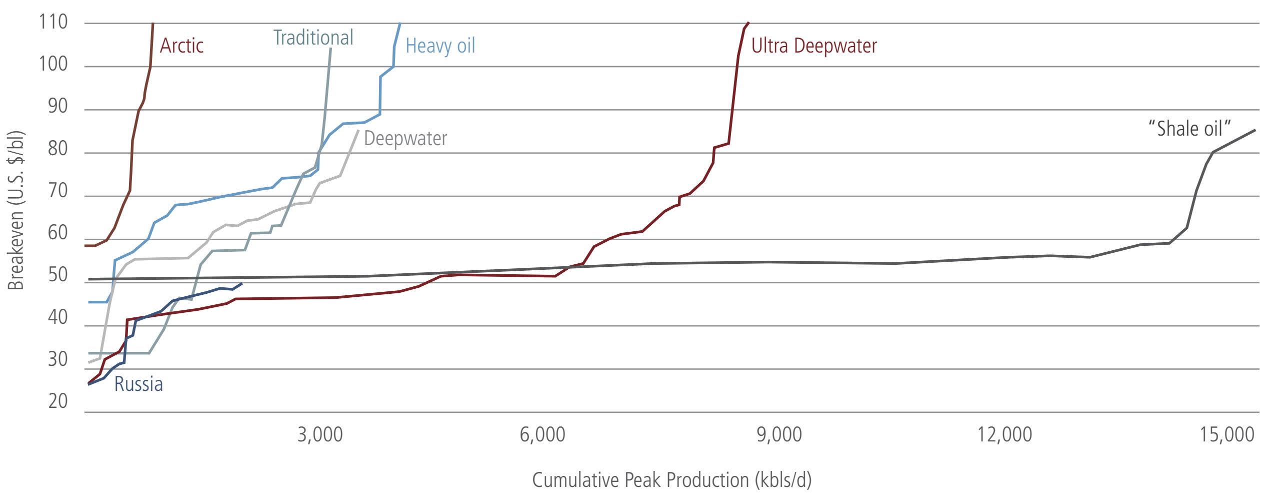
The downturn in the energy market has been extremely difficult for oil producers over the past two years. OPEC maintained a policy of unbridled production growth to increase its market share, resulting in an oversupplied market and low oil prices. The shakeout in the oil patch caused stress within the sector along with some bankruptcies among higher-cost, more leveraged players. But low-cost North American shale companies surprised many investors with their resiliency—and increased efficiency. For example, while it used to take about 20 – 30 days to drill a well, now it takes 5 – 15. In conjunction with faster drilling times, the wells being drilled are larger, with "lateral" wells expanding from some 5,000 feet a few years ago to around 10,000 feet today.

Nowhere are these productivity gains more apparent than the Permian Basin of West Texas and New Mexico. Of the 192 oil rigs added since the market bottom in May, 114 (or 66%) are in the Permian. Recently, "Per-mania" has taken the form of M&A activity, with about 50 property deals last year (worth over $12 billion) and more expected for 2017. Given better efficiency, drillers with core acreage appear able to achieve double-digit "full-cycle" returns (over the life of the well) with oil in the $40–$50 range, which is below the U.S. shale average as seen in the chart below.

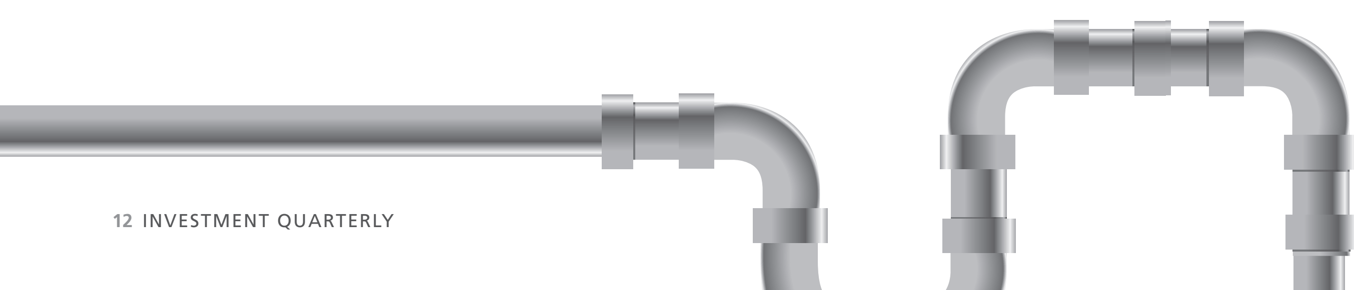
[1]Source: FactSet (S&P 500 Energy).

COST CURVE BY REGION/DRILLING TYPE

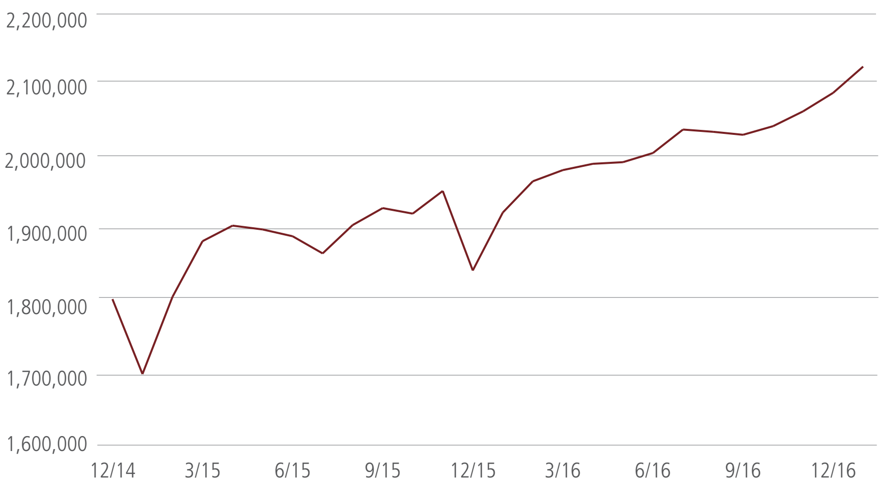
Shale efficiency may translate into both the low cost and volume needed to gain global market share.



Source: Goldman Sachs Global Investment Research.



PERMIAN BASIN PRODUCTION (BARRELS OF OIL PER DAY)



Source: U.S. Energy Information Agency, U.S. Capital Advisors.

Examining total U.S. oil production data as of September, volumes were down by about 1 million barrels per day from the peak of 9.63 million (or 11%) reached back in April of 2015. However, there are signs that these declines may be behind us. Higher oil prices have helped lead to a 67% increase in the oil rig count from its lows, and, combined with efficiency gains, have begun to reverse the volume declines, with October onshore oil production in the lower 48 states rising by 100,000 barrels per day from September levels. Looking at forecasts for total U.S. oil production growth for this year, consensus estimates are pointing toward volumes rising to 9.3 million barrels per day toward year-end, up about 500,000 barrels per day from year-end 2016, primarily driven by "lower 48" shale drilling.

Gauging the Trump Effect

Beyond an improving supply/demand picture, shifting political winds are contributing to optimism about energy. But distinguishing the headlines from the facts is important across the sector.

Coal Reality. Former President Obama was clearly looking to phase out the climate-unfriendly coal industry, employing executive orders and regulation to make it more difficult and costly for coal producers to operate. However, out-of-work coal miners became a talking point in the election, and Donald Trump insisted he would roll back the regulations and bring back thousands of coal jobs. Unfortunately, the reality is more nuanced. In our view, it isn't only regulation that is shrinking the coal industry, but also cheap and abundant natural gas, which continues to prompt the retirement of coal-fired generation facilities.

This is not to say that coal will disappear. The U.S. needs diversified power sources—you can't count on gas, nuclear and renewable energy alone to meet energy needs. Moreover, not all coal production is "dirty." Some eastern plants that burn high sulfur coal have scrubbers in place that help them pass emissions tests; out west, you can find low sulfur coal that is inexpensive and less polluting. Even Trump, when speaking about coal, has said he wants the "clean" variety.

Higher oil prices have helped lead to a 67% increase in the oil rig count from its lows, and, combined with efficiency gains, have begun to reverse volume declines.

If the new president reverses some of Obama's executive orders and pulls out of climate change deals, you may see some antiquated coal plants survive a little while longer, but the long-term shift from coal to natural gas is likely to continue.

Breaking the Pipeline Impasse. One potential positive for energy relates to infrastructure. Conflicts over pipeline development have become increasingly intense, as shown by the protests over the Dakota Access pipeline last year. This has made approvals more uncertain and time consuming. A more industry-friendly approach at the federal level could lend support to the pipeline business, which in turn will help producers. At the same time, state-level politics do matter and will still need to be evaluated and monitored.

Foggy Tax Picture. The corporate tax cuts and loophole closures advocated by Trump would generally be positive for business, but energy-specific tax rules make any impacts more subtle across the sector. Many exploration and production (E&P) companies are not high-cash taxpayers due in part to "intangible drilling credits" received for ongoing drilling activity, so a lower tax rate may be a more modest benefit to these companies. Additionally, proposed changes to border taxes (on non-U.S. goods made by domestic companies) will need to be monitored closely. Assuming natural resources are not exempted, they could have different implications across energy sub-sectors. For example, domestic refiners could be particularly at risk, given their use of foreign oil, but domestic producers could benefit.

Changes in trade policies and dynamics, including the proposed border tax, will be important to assess as they relate to the sector.

Key Variable: Tension on Trade

Both oil and natural gas are global commodities, so a functioning and growing global economy is needed for a healthy backdrop in the energy sector. As a result, changes in trade policies and dynamics, including the proposed border tax, will be important to assess as they relate to the sector. While much has been said about trade agreements and tariffs, at this point, it appears many details still need to be negotiated and finalized. Given energy-friendly cabinet appointments (most notably Exxon CEO Rex Tillerson as secretary of state), we think Trump will be cognizant of disrupting the sector.

Looking at the U.S. specifically, the country still imports roughly 8 million barrels per day of oil (predominantly heavier grades of crude).[2] Additionally, it has been growing fuel product exports, is about to begin exporting larger quantities of natural gas, and, in the next year or two, could also export more oil (depending on the speed of light oil growth from shale), so changes on the trade front matter greatly.

Political and Fundamental Tailwinds

For two years, OPEC worked to both maximize production and discourage higher-cost competition. But the resilient response from producers in North America, Russia and elsewhere made the tactic too difficult to maintain. If OPEC members can avoid back-peddling (an issue in the past), their current agreement will likely help provide a floor under global oil prices and support many U.S. oil and gas companies in the year ahead. At the same time, the political influences we've described, although still with many unknowns, will be key to the future of the sector. As always, the outlook remains tied to global economic prospects. At this point, the International Energy Association suggests a healthy 1.3 million barrels per day of demand growth this year. Assuming OPEC cooperates, and U.S. production does not exceed expectations, that bodes well for the sector in 2017.

[2] As of December 31, 2016.

NAVIGATING MIDSTREAM (INFRASTRUCTURE)

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COMPANIES DEDICATED TO SUPPORTING THE FLOW OF ENERGY ARE OFFERING NEW OPPORTUNITY.

The North American shale revolution has unlocked substantial supplies of hydrocarbons—specifically natural gas, natural gas liquids and crude oil. Midstream energy companies own and operate the infrastructure that processes, transports, stores and exports these commodities. In our opinion, the growth in supply and consumption of hydrocarbons (in particular, natural gas and natural gas liquids) should bode well for well-positioned midstream companies.

The U.S. sits on an abundant and relatively cheap resource base of natural gas, natural gas liquids and crude oil. Midstream companies will likely play a vital role in building the new infrastructure to facilitate the development of these resources and connect supply regions to end markets. Our team is currently focusing on emerging and long-term positive trends such as the U.S.'s emergence as a significant energy exporter. In addition, demand for natural gas and natural gas liquids will likely continue to grow globally due to increased natural gas-fired power generation and new petrochemical facilities.

The improvement in energy prices has enabled the stock prices of midstream companies to recover from 2016 lows. Stable oil prices and a new presidential administration that supports both deregulation and further investment in energy infrastructure could prove to be significant tailwinds, in our view, for midstream companies over the next few years.

The midstream infrastructure investible universe continues to evolve and currently includes MLPs and C corporations, as well as utilities with midstream exposure. We believe there is widespread dispersion in the group's valuations and hence see an opportunity for investors to exploit these inefficiencies, including via active portfolio management. Recent earnings reports confirm that high quality midstream companies have continued to generate stable and growing cash flows; we are optimistic that this trend can continue and even improve over the next few years.

ESTATE PLANNING: IT'S MUCH MORE THAN TAXES

Diane E. Lederman, Chairman, Neuberger Berman Trust Company N.A.

Building an airtight plan for your legacy has never been more important.

The current environment is filled with anticipation regarding potential shifts in U.S. policies on taxes, trade, foreign policy and regulation. Although not center stage, estate and gift taxes are an area of possible change, with potential impact on estate planning techniques. Without speculating on what will happen, it's worth remembering that there are plenty of nontax benefits to a carefully developed estate plan. Here are seven of them for your consideration:

Careful estate planning can define your intentions across family, charity and business.

1. Control your legacy. An estate plan allows you to decide not only who gets what, but also when and how they will inherit. Without a will, trust or beneficiary designation (for certain types of assets), assets are typically subject to state intestacy rules, which may provide for distributions very different from what you might want. For example, some states require that if you are survived by a spouse and children, your estate is divided between them, even if your children are minors. Do you want to leave your beneficiaries an inheritance outright or in trust? And what terms should the trust have? These decisions are part of the planning process. More broadly, careful estate planning can define your intentions across family, charity and business.

2. Name your executor and trustee. In the absence of naming an executor and trustee, state law and the courts will control who administers your estate. The administration of trusts and estates and the decisions fiduciaries must make have become more complicated given current law, both at the federal and state levels. Investment of estate and trust assets has also become more complicated, while family relationships are often complex. All of these issues should be considered when naming an executor and trustee.

A corporate fiduciary is one option that can provide for the professional management of your estate or trust and offer access to jurisdictions other than your state of residence, enabling you to take advantage of favorable laws in those locations. A corporate fiduciary can also add expertise and handle day-to-day administrative duties. As an objective third party, a corporate fiduciary can help minimize the impact on family relationships that result from the decisions a fiduciary must make. Having a family member or friend act as a co-executor or co-trustee alongside a corporate fiduciary can add personal insights without burdening that individual with more onerous trustee and executor responsibilities.

3. Provide for your children. Your will can name a guardian for your underage children, without which a judge might have to make the decision without your input. Moreover, your legacy to them can be as simple or individualized as you want. You can establish trusts that will hold assets you bequeath to them until the child reaches a certain age or last for their lifetime or a bit of both. In the absence of a trust, minor children will need a court-appointed Guardian of the Property to oversee any assets they inherit.

4. Give to charity. Regular charitable donations are an informal way to both help the greater good and generate itemized tax deductions. However, a more formal approach can also be beneficial. Depending on your charitable goals, there are a variety of ways to benefit charity. Whether using a split interest trust like a Charitable Lead Trust or a Charitable Remainder Trust, a direct payment to charity from your IRA that satisfies your RMD (up to $100,000 per year), a contribution to a donor-advised fund or the creation of a private foundation (which can be in trust or corporate form), all can help you achieve your philanthropic and other goals.

Through an effective team of advisors, you can create a framework to grow and protect wealth across generations.

5. Plan for incapacity. Your estate plan can put in place measures to handle your affairs should you become incapacitated. Although one common approach is to use a Power of Attorney (POA), that can come with drawbacks: Some financial institutions may make POAs difficult to use or may not accept them, and at your death the agent's power terminates and there is no one authorized to act until an executor or personal representative is appointed by the court. Another approach is to have *both* a POA and a Revocable Trust. With a revocable trust, you are the trustee until death or your earlier incapacity, after which a successor trustee steps in. The successor trustee can continue to act after you pass away, and protect and manage the assets. A revocable trust will only achieve this objective if assets are transferred into it during your life. Many people transfer just their liquid assets into the trust during their life. That way, a successor trustee can step in seamlessly to take control at your death or incapacity. Other key documents to consider in relation to incapacity include a health care proxy giving an agent the ability to make medical decisions on your behalf, and a living will, which indicates your intentions should you become terminally ill.

6. Transfer your business. For many wealthy individuals, the creation of their business has been the engine of their financial success. Effectively handling its eventual disposition is essential to assuring that its benefits can accrue to heirs, whether as a financial asset or an ongoing concern. As part of your planning, you should consider addressing succession planning for the operations of the business as well as inheritance issues. There can be some particularly sensitive issues to be worked through where some family members are involved in the business and others are not.

7. Plan for special needs. Having a beneficiary with disabilities creates an additional dynamic for your legacy. Depending on their issues, they may not be able to support themselves or have the capacity to make financial and life decisions on their own. If qualifying for public benefits is a goal (which may include assistance but also access to educational or life skills programs), structuring an inheritance is critical. A special needs trust is designed to provide for your beneficiary without disqualifying them from government benefits.

We could go on. Estate planning can serve many functions, from broadly distributing your assets, to facilitating charitable goals, to handling specific situations such as blended families or the needs of disabled beneficiaries. Creditor protection is another key function that can potentially be addressed through the use of a trust. Through an effective team of advisors, you can create a framework to grow and protect wealth across generations. Regardless of tax developments, such benefits reinforce the need for the development and regular review of an individualized and comprehensive estate plan.

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