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PRIVATE WEALTH

FALL 2023

Aspire

Running the 'Last Mile'

INVESTORS WILL LIKELY BENEFIT FROM ENDURANCE AND FLEXIBILITY AS CENTRAL BANKS ENTER THE LAST STAGES OF THEIR RACE TOWARD PEAK INTEREST RATES.

IN THIS ISSUE

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Pressing Ahead

RISK IS ALWAYS WITH US, BUT SHOULD INFORM—NOT DERAIL—OUR ACTIONS.

The hazards often discussed in investment circles are typically serious but rather ordinary. Higher interest rates, an economic slowdown, a few missed earnings numbers. They tend to impact market conditions and personal wealth, but don't hit us with devastating force. The same cannot be said for human tragedies like the recent attacks on Israel. Our hearts go out to the victims and their families.

Over time, the world presents new ways to shock us, often in the form of conflicts and bloodshed, but sometimes through disease, natural disasters or simple misfortune. It bears noting that geopolitics often hover at or just below the surface: shifting strategic alignments, the growth and spread of deadly arsenals, old-world grudges that have survived to the modern age—there is plenty to worry about.

One surprise may be that our leaders (flawed as they may be) often find a way to work through these issues in the name of common survival. Another is that, from a financial perspective, the realization of such hazards generally fails to derail the economy and financial markets on more than on a transitory basis. The truth is that you can never eliminate risk, you can only manage it. So, it's important to use the control that you have to help shape positive outcomes.

From an investment perspective, this can mean acknowledging uncertainties and setting strategy and allocations to work through them. In her outlook article on page 3, Shannon Saccocia, Chief Investment Officer for NB Private Wealth, observes that in the Fed's "last mile" toward peak interest rates, attention to valuation, stretching fixed income maturities and considering alternative assets are currently prudent investment steps.

To us, it's also important to assess investment structures to see if they are achieving what they claim. Doug Kramer, the Head of our Institutional Equity and Multi-Asset team, suggests "reading the fine print" on ever-popular index funds to understand their hidden costs and risks in complementing other portfolio solutions (see page 15).

Recent Events

Future-Proofing Portfolios

Shannon Saccocia, Chief Investment Officer–Private Wealth, appeared in September at the Future Proof Conference in Huntington Beach, CA, in a session on "Decoding the Rise of Alts." The world's largest wealth management festival, Future Proof brings together top professionals to educate and strengthen our industry.

Nonprofit Series: Board Leadership

Julia Chu, Head of Philanthropy and Family Governance Advisory, headlined our three-part series on Advancing Nonprofit Board Governance, exploring three tenets of effective board leadership, including fiduciary oversight, strategic planning and marshalling resources, to help enhance community and philanthropic impact. Above, she's joined by Maria Angelov, Head of Corporate Social Responsibility, who also took part.

In terms of wealth and estate planning, we favor capitalizing on tax savings and wealth transfer opportunities, particularly given the post-2025 sunset of favorable 2017 tax rules. In a "Reality Check for Year-End" on page 8, Steve Polizzi, Director of Wealth Planning, Julia Chu, Head of Philanthropy and Family Governance Advisory, and Sam Petrucci, Head of Advice, Planning and Fiduciary Services, provide an array of ideas to help facilitate long-term planning goals.

Of course, well-being isn't just financial, and should extend to a range of personal aspirations (hence the name of our publication!) including, in many cases, effective charitable giving. In her latest philanthropy column (see page 20), Julia notes the parallels between investment and nonprofit "portfolios," and offers practical tips to consider in order to construct and execute an effective charitable approach.

Finally, as part of our ongoing dedication to the arts, we often feature artists and art-related topics on these pages. In this issue, we include an essay on page 25 from Richard Aronowitz, Global Head of Restitution at Christie's auction house, who reflects on the impacts of the Washington Principles on Nazi-Confiscated Art, a nonbinding, ethically driven code introduced a quarter century ago to address the disposition of art stolen under the Nazi regime.

As always, we are here to serve you, whether through integrated investment wealth planning, or general communications and events (some highlighted at left). All are designed to help you navigate the markets and realize your purpose.

Thank you for the trust you have placed in NB Private Wealth.

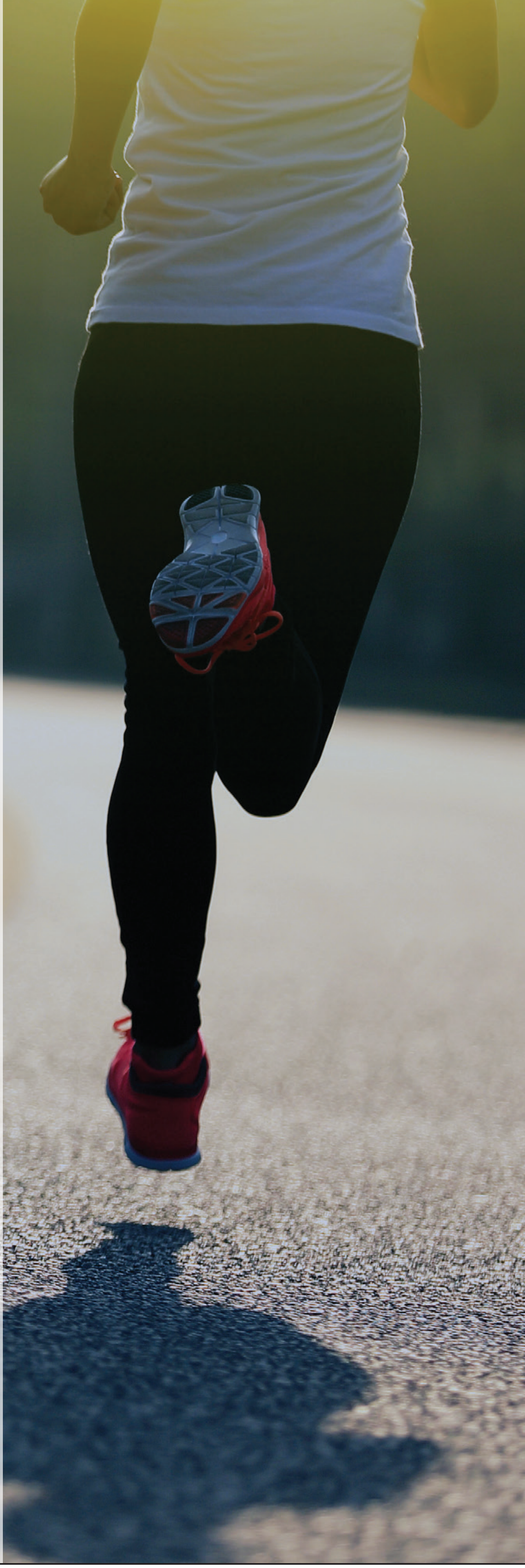
Sincerely,

Stephanie

Stephanie B. Luedke, CFA
Head of NB Private Wealth

Running the 'Last Mile'

Recent months have suggested a more difficult path for investors as central banks enter the last stages of their race toward peak interest rates. Although U.S. growth has remained resilient, stubborn inflation has proven disappointing while signs are growing of economic wear-and-tear that endangers soft-landing scenarios. Investors will likely benefit from endurance and flexibility in working through the current landscape in seeking to achieve long-term goals.



SHANNON SACCOCIA
Chief Investment Officer—NB Private Wealth

A fork in the road may be viewed with caution or as an opportunity. In recent months, investors faced their own proverbial fork, as the persistence of rallies in the equity and bond markets came into question. In both cases, momentum in the first half of the year proved difficult to maintain, and many sought shelter in safer havens such as cash.

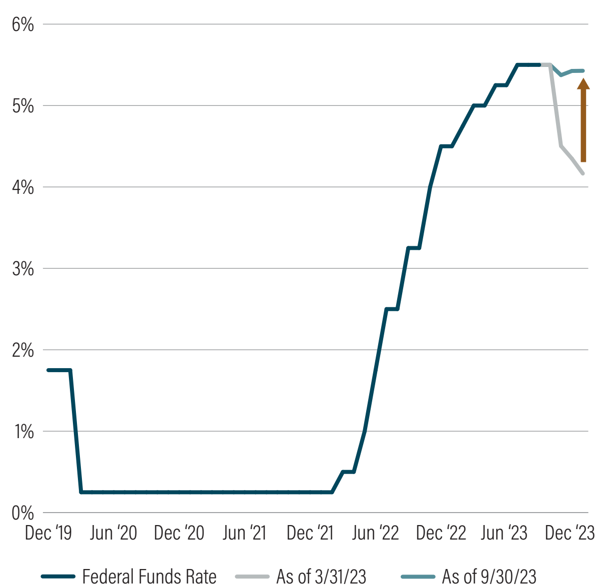
Larger-capitalization, more value-oriented equities delivered relative performance in the third quarter, but that does not mean that returns were positive—only three S&P 500 sectors posted gains for the period (energy, financials and communication services). Outside of the U.S., there were some pockets of strength, as U.K., Japanese and Indian equities advanced. Within fixed income, a move higher in global yields (excluding U.K. gilts) hindered returns; losses in government and investment grade corporate bonds were offset in part by strength in high yield issues, which are still enjoying low default rates.

So, what changed? In our view, three shifts set the stage for recent performance:

First, the Federal Reserve updated both its "dot plot" of future policy rates and, more importantly, its economic projections, to reflect a higher-for-longer interest rate stance. With the U.S. economy performing better than expected, the Fed anticipates less downward pressure on rates in 2024—not a welcome development for an equity market typically driven by multiple expansion. This conceptual reset pushed up the longer end of the fixed income yield curve, forcing a "rerating" of both stocks and bonds.

RATE FORECASTS HAVE SHIFTED UPWARD

Fed Funds Rate Market Expectations



Source: Federal Reserve, as of September 30, 2023.

Second, food and energy costs reaccelerated globally, coincident with growing concern that the post-pandemic boom in consumer spending may be coming to an end. While central banks focus primarily on "core" inflation measures that exclude food and energy, economists understand that near-term price fluctuations for these necessities can undermine confidence.

Third, expectations for China's economic growth moved lower, based on a slower consumer rebound and concerns about the country's debt-laden real estate market. While still maintaining hopes for stimulus, investors are dealing with the reality that a China recovery is unlikely this year and could be further delayed by policy and geopolitical tensions.

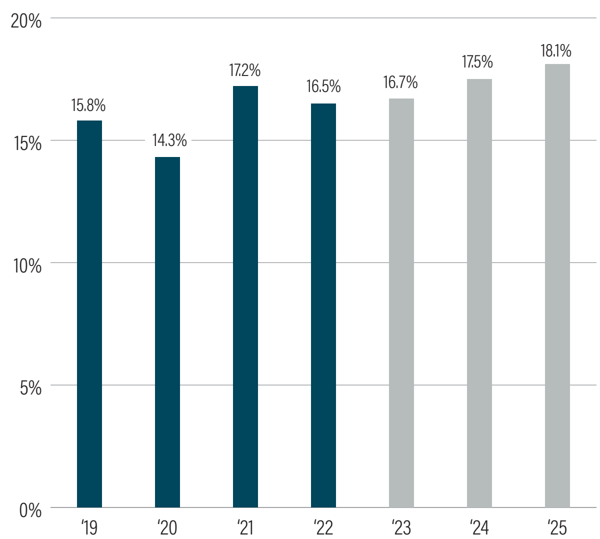
RECESSION OR NOT?

Underlying these changes has been a shifting narrative as to the likelihood and timing of a U.S. recession, as more investors have moved from expecting a soft landing to anticipating a "no landing" where growth barely slows at all. Note that, at the start of the year, many forecast a recession in 2023 or 2024, but became more optimistic on stronger-than-expected consumer spending, employment and corporate earnings, as well as residual federal stimulus and reduced energy disruption in Europe.

In fairness, some of these factors were difficult to anticipate. Mild weather reduced Europe's energy supply crunch, while U.S. demand for workers remained unexpectedly robust even with higher wages. Margin pressure was also not as pronounced as feared, as inflation helped drive topline growth, while corporate managements executed well despite inexperience with inflation, helping earnings surprise to the upside. Consumer spending shifted from goods to services, and although housing demand declined due to higher interest rates, lower supply created a floor for prices and contributed to household wealth.

PROFITABILITY HAS STAYED ON TRACK

S&P 500 Operating Margins



Source: FactSet, as of September 30, 2023. Operating margins are interest before debt and taxes. 2023 and after are forecasts.

So, what are the risks? First, there's higher food and energy prices, which are due in large part to supply constraints and greater demand tied to economic growth. Their reacceleration comes at a difficult time, as savings are being depleted and retailers are approaching the all-important holiday shopping season. In addition, yields have drifted higher, raising the cost of debt. The higher levels of interest demanded of consumer and corporate debtors suggest that difficult choices will need to be made—leading to greater scarcity and lower spending. A shift toward reduced fiscal stimulus combined with soft consumer spending could prove difficult for the global economy.

Mideast Conflict and the Markets

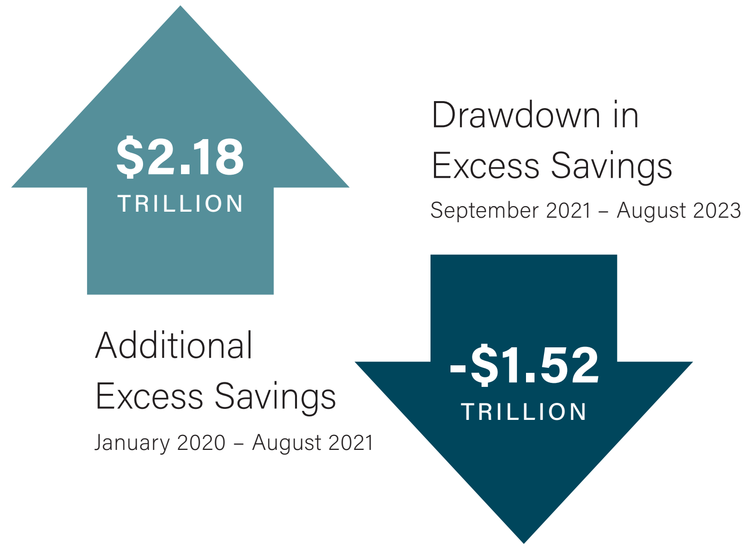
On October 7, the Hamas terrorist group staged an unprecedented attack on Israel, launching thousands of missiles from strongholds in the Gaza strip, and sending its fighters into southern Israel to capture, abduct and kill civilians.

Israel responded by declaring war on Hamas, reestablishing control of the territory affected, and commencing military action to destroy or oust Hamas from Gaza. The global community has largely condemned the terrorist attacks, while the U.S. has positioned warships in the region to support Israel in the event of wider conflict.

From a market perspective, the initial reaction was muted, with modest equity declines and a surge in oil prices. However, stocks later recovered as investors saw an easing of bond yields associated with a "flight to quality" and reduced expectations of an upcoming Federal Reserve interest rate hike.

Longer term, the narrative is less certain, as the magnitude and duration of impacts from geopolitical events tend to be tied to the broader economic backdrop. With higher energy prices already weighing on expectations for consumer demand and corporate margins, renewed conflict in the world's major oil exporting region could have ripple effects far beyond the Middle East.

Savings Reversal



Source: Bloomberg.

PREPARING FOR THE NEXT LEG

The path for 2024 remains uncertain, but we see three areas of focus in evaluating portfolio solutions for such an environment: valuation, duration and "expansion." First, investors need to assess the valuation at which assets are trading and determine where the relative opportunities lie. For example, when comparing the S&P 500, which is market capitalization-weighted, with the equal-weighted S&P 500, you find that valuations for certain sectors and industries are more attractive.

Growth differences, too, can inform geographic allocations: While China may grow at a slower pace, the rotation in manufacturing to other Asian countries could see beneficiaries rewarded with richer market multiples. Even with the recent swoon in U.S. stocks, valuations on both non-U.S. developed and emerging markets appear less extended, although a combination of the resurgent dollar and growth uncertainty are currently weighing on those markets.

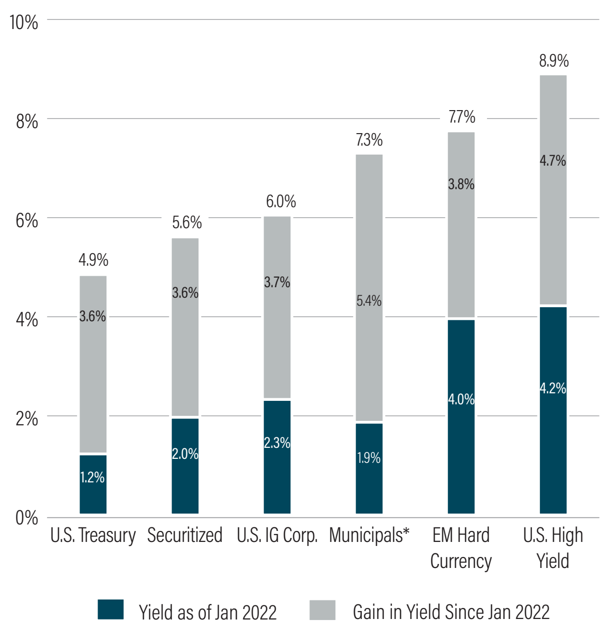
In addition, given the likely "higher-for-longer" rate environment, total returns offered by fixed income are likely to come from yield rather than capital appreciation—a sharp departure from the zero-interest-rate environment in place after the global financial crisis. This change in return expectations—and the potential volatility of those returns—has longer-term implications for portfolio construction, but in the near term affords investors the potential benefit of lowering overall portfolio risk.

This leads to a second area of focus: duration, or sensitivity to interest rates. Duration has historically been associated with fixed income, but the rates-driven swoon in high-multiple, high-growth and low-profitability equities in 2022 reinforced the importance of understanding the way rates influence the valuation of corporate cash flows. The spike in market rates largely caused 2022's performance rotation from growth to value, and anticipation of lower rates may have been the source of this year's resurgence of growth stocks.

Looking at the duration of assets across your portfolio will be critical, as remaining too short—in both stocks and bonds—could create reinvestment risk. Instead, locking in higher yields by extending duration in fixed income, and identifying sectors, industries and companies that can grow revenue even with inflation firmly anchored, could potentially create more positive outcomes.

INCOME ON THE HORIZON

Yield by Fixed Income Segment



Source: Bloomberg. Nominal yields as of September 30, 2023. U.S. Treasury is represented by the Bloomberg U.S. Treasury Index; Securitized by the Bloomberg U.S. Securitized: MBS/ABS/CMBS and Covered Index; U.S. IG (Investment Grade) Corp. by the Bloomberg U.S. Corporate Bond Index; Municipals by the Bloomberg Municipal Bond Index; EM Hard Currency by the Bloomberg Emerging Markets Hard Currency Aggregate Index; and U.S. High Yield by the Bloomberg U.S. Corporate High Yield Bond Index. (*)Municipal yields are on a tax-equivalent basis, assuming a marginal tax rate of 37% and ACA of 3.8%, for a total of 40.8%.

The last area of focus is expansion. In the summer issue of *Aspire,* we cited the benefits of being a liquidity provider in a market where liquidity is scarce, or at least significantly more expensive. The complex environment facing private companies is likely to continue to produce opportunities for liquidity providers, but could also set the stage for attractive longer-term outcomes. Recent IPO activity may be a sign of things to come, but even if public market transactions accelerate in 2024, there remains meaningful pent-up demand in the private markets. As such, where feasible, it may make sense to expand the scope of portfolios to include private equity and credit—which could benefit investors well beyond the current interest rate and economic cycle.

RACE FOR HOME

Whether in a marathon or the normalization of interest rates, the "last mile" of a race requires persistence. Globally, we are likely approaching the end of the current tightening cycle. The disinflationary trend, despite the recent uptick in energy and food, appears to be intact, which implies that, at some point, inflation will approach the target rate, and central banks will need to loosen policy. Timing that inflection point, however, may be a heavy lift.

The overall interest-rate sensitivity of the U.S. economy, in particular, has come into question, as household net worth is still rising while the extra yield provided by non-Treasury markets remains in historical ranges. Our view is that America is likely more interest-rate sensitive than recent data would suggest. Particularly given currently bloated debt burdens (consumer, corporate and governmental), we think interest-rate volatility is likely to produce short-term variability in returns across markets. Lagging effects of monetary policy could still be present through much of next year, while the impact of government spending remains in question.

In short, we've seen great progress on inflation since the pandemic, and the global economy is certainly in better shape than many anticipated. But this next, last mile for policymakers could prove a challenge, suggesting that investors should stay focused and maintain strategic positioning in order to continue making progress toward long-term goals.

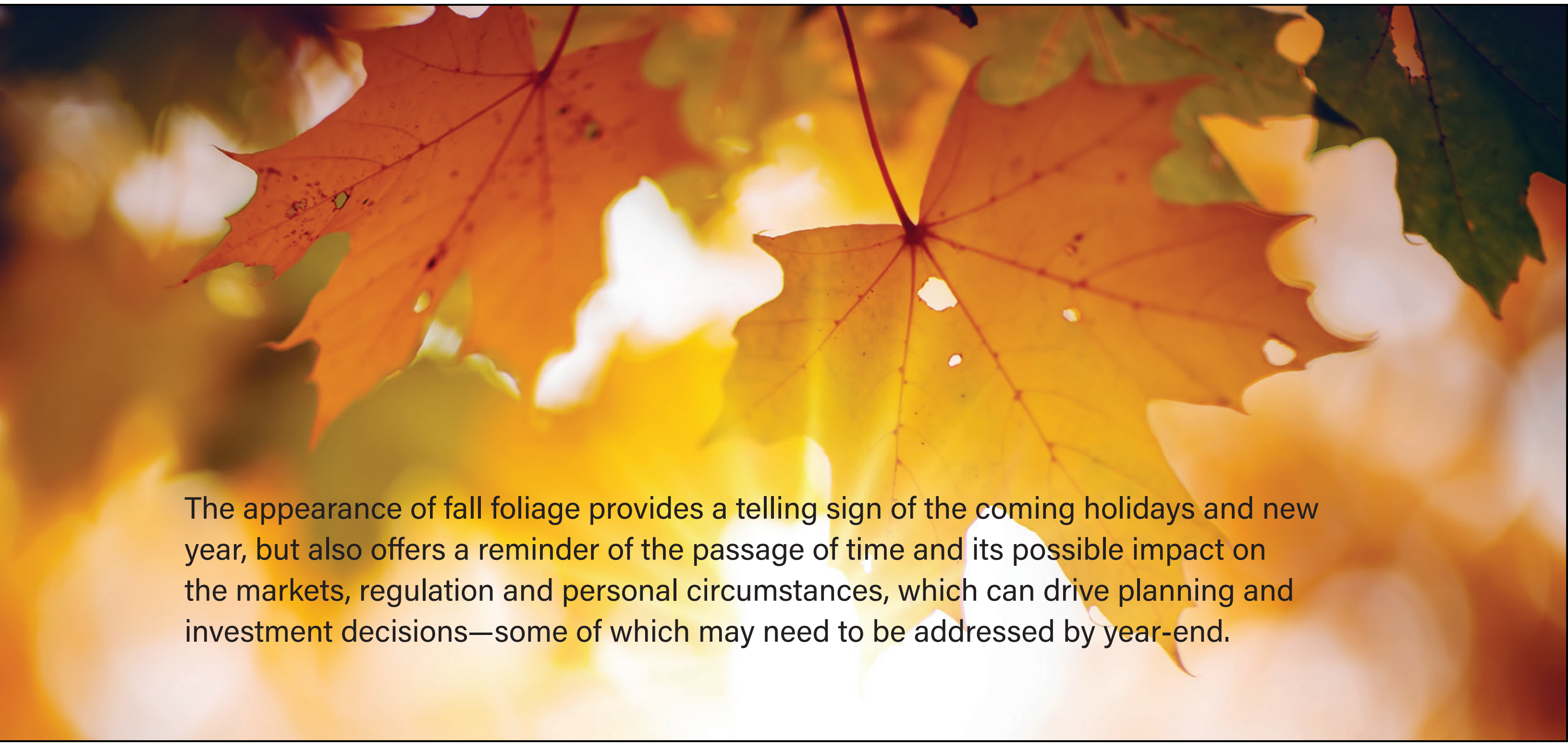
Reality Check for Year-End

STEPHEN P. POLIZZI, CFP®
Director of Wealth Planning

JULIA CHU
Head of Philanthropy and Family Governance Advisory

SAM PETRUCCI
Head of Advice, Planning and Fiduciary Services

The changing market climate and countdown to federal tax sunsets after 2025 should provide impetus to review portfolios and planning strategies.



The appearance of fall foliage provides a telling sign of the coming holidays and new year, but also offers a reminder of the passage of time and its possible impact on the markets, regulation and personal circumstances, which can drive planning and investment decisions—some of which may need to be addressed by year-end.

Look no further than the stock market to understand the value of careful review. Given the year-to-date strength of equities, you may have questions: Am I now overweight stocks? Would it be beneficial, given higher yields, to augment my bonds holdings? And should I consider additional exposure to private markets? All are important issues, but there are others as well. You may wish to take additional steps to limit risk, seek to reduce tax liability, contribute to a charity or transfer wealth to family members, to name a few examples.

Here are some ideas to consider in the waning months of 2023.

MANAGE RISK AND TAXES

For investors, risk may extend beyond asset allocation to the presence of concentrated holdings. The typical rule of thumb is to keep any individual stock below 10% of your portfolio, which means that it may be prudent to trim some holdings. Realized gains may be offset by losses, so it's important to connect with your wealth or portfolio manager to clarify your potential gain/loss picture for the calendar year. Select loss "harvesting" may be appropriate: You can offset realized capital gains and up to $3,000 of ordinary income with losses, whether realized in 2023 or carried over from previous years. Be sure to abide by wash sale rules, which apply if you purchase the same or substantially identical securities (or acquire a contract or option to do so) within 30 days before or after the sale resulting in a loss.

ORGANIZE YOUR CHARITABLE GIFTS

Year-end is an active time for making charitable donations, but the checkbook giving that many of us employ can be time-consuming and inconvenient. Taking a more organized approach can help to streamline this process and potentially make giving more effective.

Along these lines, a donor-advised fund (DAF) can serve as a single tax-free charitable account to support multiple nonprofits, and to also track your giving. If desired, you can pair DAF funding with tax-efficient investing, as donating appreciated marketable securities (e.g., stocks and mutual fund shares) held for over a year can serve as a tax-free way to reallocate your portfolio as part of your annual investment review. Note that with such long-term holdings, you can take a deduction of their market value, up to 30% of adjusted gross income (AGI). (For short-term appreciated holdings, you can only deduct the purchase price. Cash donations can be up to 60% of AGI.)[1] In some cases, you may prefer to "bunch" donations in a given year to maximize tax benefits beyond the standard deduction.

[1] Any excess above these thresholds is carried forward to the subsequent five tax years. You should consult with your tax advisor as to the timing and types of donations, especially in regard to larger gifts such as business interests.

Sunset of the 2017 Tax Reform

Top Income Tax Bracket	Estate Tax Exemption	State & Local Tax Deduction Cap
CURRENT **37%**	CURRENT **$12.92 mm**	CURRENT **$10 k**
POST-2025 **39.6%**	POST-2025 **~$7 mm***	POST-2025 **Unlimited****

*$5mm base as of 2010 plus annual increases.

**Some have urged eliminating or increasing the cap prior to expiration.

Be sure to allow sufficient lead time, given the year-end deadline of transferring certain assets. For instance, it can take up to six weeks to process a mutual fund donation, suggesting the need to initiate the transfer by mid-November. In addition, nonprofit organizations vary in their ability to process noncash gifts in a timely manner. This is an opportune time for your NB Private Wealth team to review your balance sheet and work with your tax advisor to identify optimal assets to transfer and then execute your philanthropic objectives for the year.

BENEFIT FROM CURRENT ESTATE TAX RULES

We are cognizant that the clock is ticking on the generous estate tax rules enacted as part of the 2017 tax reform. Specifically, the current (2023) lifetime federal exemption of $12.92 million per person (or $25.84 million per married couple) from estate and gift tax is set to revert to past levels after 2025. Where feasible, we believe gifting above the historical exemption amount of $5 million (indexed from 2010) per person could be an effective way to move assets out of your estate on a gift-tax-free basis. For added flexibility, you may wish to employ certain trust vehicles.

Gifting on a less grand scale may also be in order. Under current law, you can give up to $17,000 ($34,000 as a married couple) gift-tax-free to as many individuals as you like in 2023, without using your lifetime federal gift tax exemption. However, all of your gifts, including those made directly to children via taxable investment accounts and/or UTMAs, 529 college savings accounts and, indirectly, to life insurance trusts to cover annual premiums, must be coordinated to ensure you don't inadvertently exceed the annual gifting limits for any one person. Also, you can pay your children's (or anyone else's) tuition directly to an educational institution, or medical expenses/health insurance premiums directly to the service providers, in unlimited amounts without dipping into the annual exclusion or lifetime gift exemption.

CAPITALIZE ON TAX-ADVANTAGED ACCOUNTS

Retirement Accounts

Use of retirement savings vehicles can provide significant opportunities for investment growth potential over time. The limit on annual employee 401(k) plan contributions is $22,500 for 2023 (plus an additional $7,500 for those age 50 or older); and you can contribute up to $6,500 to a traditional individual retirement account (IRA) in 2023 ($7,500 if you are

[2] For 2024, the exemption is $13.61 million per individual or $27.22 million per couple.

[3] The limit on tax-free gifting rises to $18,000 in 2024.

Checklist for Year-End

Your late-year financial review may include addressing these questions and more:

- ☐ Are the beneficiary designations correct on insurance and retirement accounts, particularly where you might have designated a trust for planning reasons?
- ☐ Are those named in your estate planning documents, such as trustees, executors or attorneys-in-fact, still appropriate?
- ☐ Do your payroll withholdings need to be adjusted?
- ☐ Are your Flexible Spending Account withholdings realistic, and are you on track to eliminate balances by the deadlines?
- ☐ If you are enrolled in a high deductible health plan, have you fully funded a health savings account?
- ☐ Have you reviewed your cash management strategy? With short rates at or above 5%, consider maximizing your earned interest rates while ensuring that you adhere to FDIC limits where applicable.
- ☐ Have you taken the opportunity to restructure your debt balances? Rate increases have reset many adjustable-rate mortgages higher, increasing monthly carrying costs.
- ☐ Have your circumstances changed in any way that might require a reassessment of your asset allocation, or a fresh look at your estate planning?
- ☐ Is your home adequately insured, given that valuations and rebuilding costs have increased substantially in many markets?
- ☐ Have you taken steps to protect your personal and financial data? This may include a review of your credit report to address inaccuracies or identify unusual activity.

50 years of age or older), though the tax deductibility of your IRA contribution may be reduced or disallowed if you also participate in a retirement plan at work and your earnings exceed certain thresholds. Your nonworking spouse can use your earnings to contribute to an IRA, in which case income-based phaseouts take place at higher levels than those for the working spouse. Moreover, you and/or your spouse can still contribute to a nondeductible IRA or convert a traditional IRA to a Roth IRA.

Management of RMDs

Those who have not begun taking distributions from traditional retirement plans may eventually face meaningful required minimum distributions (RMDs). In such cases, it may make sense to take some distributions to tactically "fill up" your existing tax bracket before RMD status begins, rather than expose that income to potentially higher tax rates in the future.

529 Plans

A potentially effective way to use the annual gift exclusion is to contribute to a 529 education account on behalf of a family member or other individual. It's possible to front-load up to five years of exclusions in one 529 contribution. Although the contribution isn't tax-deductible at the federal level, account assets grow tax-free, and withdrawals are also not taxable if they are used for qualified education expenses, including both college and (for expenses up to $10,000 per year) private elementary and secondary school. Many states provide a limited income tax deduction for residents who contribute to a 529. Note that, starting next year, it will become possible to convert up to a lifetime limit of $35,000 in 529 account assets to a Roth IRA where the beneficiary and account have been in place for 15 years, subject to Roth contribution limits and the beneficiary's earned income levels.

ASSESS YOUR INSURANCE COVERAGE

Insurance is a cornerstone of your financial picture that can sometimes be overlooked. Consider reviewing your policies to ensure there are no gaps in coverage should you or your family members be party to a lawsuit or legal judgment. Excess personal liability (or umbrella) insurance can be crucial, providing a backstop in the event you are sued for amounts in excess of the regular liability coverage offered by homeowner and automobile policies. As a general rule of thumb, you should consider coverage of up to your net worth to protect your family's assets.

Also, assess whether you might benefit from coverage for future long-term care, which can be a particularly costly outlay late in life. Individuals typically begin to consider whether or not to have this type of coverage between the ages of 50 and 70. Eligibility and premiums are a function of the applicant's health and age at the time of application, as well as the type of policy and features selected.

Finally, consider reviewing your life insurance coverage to ensure that your loved ones are properly protected. Look closely at death benefits, and, for those with permanent policies (i.e., whole life, universal or variable), make sure the policy is performing as projected when originally purchased. In our view, it would be prudent to request in-force illustrations from the insurance carrier every couple of years to make sure there are no surprises down the road.

THE BIG PICTURE

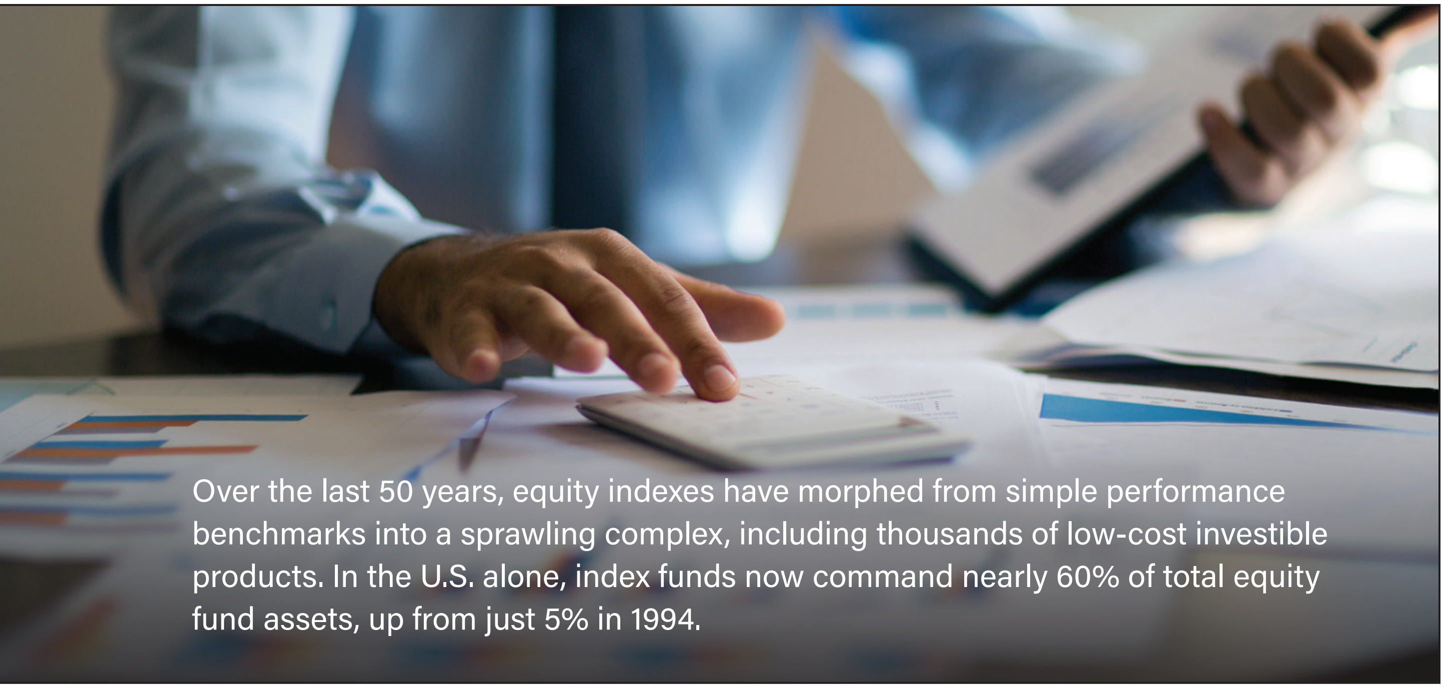
The economic and market landscape continues to evolve, making it important to work with your advisors to ensure that your accounts and planning are in line with your individual needs and can fully capitalize on currently available wealth strategies. Importantly, your financial life can change dramatically over time. Marriage, divorce, the birth of a child and health issues, among others, may require an array of strategies across disciplines, from insurance to estate planning to asset allocation.

Working with your NB Private Wealth team, you can develop a plan to help navigate through these issues.

DOUGLAS KRAMER Head of Institutional Equity and Multi-Asset

Index Investing: Reading the Fine Print

INDEX FUNDS MAY COME WITH COSTS AND RISKS THAT AREN'T WELL UNDERSTOOD BY INVESTORS.



While acknowledging the benefits from passive investing's low-cost revolution, we believe it has introduced various hidden costs for investors and may even threaten the underlying functioning of markets. In this article, we explore some misunderstood aspects of indexation, their potential long-term ramifications for markets and complementary solutions for investors.

FROM BENCHMARK TO BONANZA

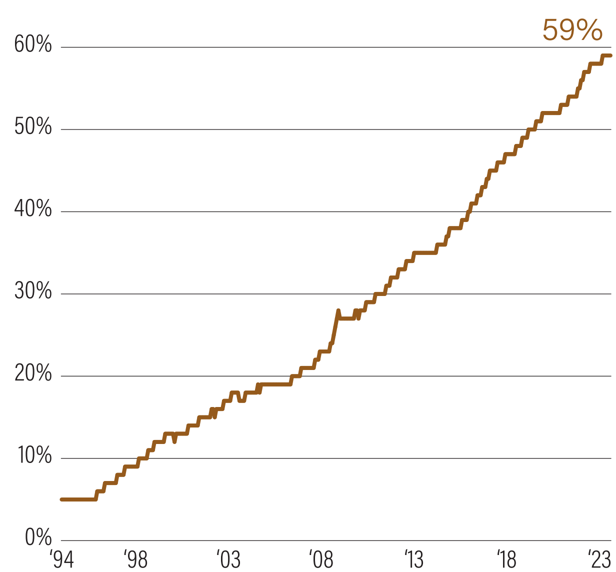
Markets are based on a fundamental mechanism: price discovery. When many participants strive to determine the worth of a security, price can maintain a dependable, if imperfect, relationship to value. This allows markets to function properly and ultimately helps maintain financial stability.

Indexation has little to do with price discovery. Index-based vehicles track baskets of securities based on criteria such as the market capitalization of each company in the basket. This robotic approach keeps asset-management fees low in part by avoiding the analytical rigor required to model companies' financial prospects and explicitly justify their valuations. While low fees have proven a powerful draw given that many active managers undershoot their performance benchmarks net of fees, we believe indexing can also come with hidden costs and gradually rising long-term risks for investors.

Nearly 140 years after Dow Jones created the Dow Jones Transportation Index in 1884, indexes have morphed from simple benchmarks created by data services companies into thousands of low-cost investible products sold by generally large asset managers with portfolios measured in the trillions of dollars, and accounting for an substantial proportion of investment assets (see display below).

THE REMARKABLE RISE OF PASSIVE INVESTING

U.S. Passive Equity Fund Assets, % of Total Equity Fund Assets



Source: Morningstar, as of August 2023.

To better grasp the impacts of this tectonic shift, it helps to take a closer look at the evolution of indexation—as well as the powerful business model now churning beneath it.

In 1976, Vanguard founder John Bogle launched the first index mutual fund, which tracked the returns of the S&P 500 Index. Bogle's breakthrough—and the vast complex it spawned—would allow investors to gain exposure to various indexes and thus easily assemble theoretically diversified portfolios, all at low cost.

As indexation's popularity grew, the industry had to adapt to meet demand, starting with the for-profit index creators. The big three—including S&P Global, FTSE Russell and MSCI, with $210 billion in collective market capitalization—generate significant revenue by licensing their indexes to asset-management firms, which in turn create low-cost investment funds based on those indexes.

The challenge is doing all of this at tremendous scale. Tracking indexes requires liquidity—without it, demand shocks can lead to pricing distortions and overconcentration among an index's more thinly traded constituents. As a result, index providers often make ongoing adjustments to their indexes to maximize liquidity and help their customers (i.e., fund managers) grow.

While this model has proven very profitable for the industry, and has ultimately allowed many investors to build affordable, balanced portfolios, it has come with hidden opportunity costs. Moreover, it invites overconcentration within these products, contributes to reduced stewardship by shifting more voting control to a handful of large institutions, and could increase overall financial instability by thwarting the market's fundamental price-discovery mechanism.

WHY INDEXING ISN'T TRULY 'PASSIVE'

Indexing began as a way to buy an entire market. But as trillions of dollars have sloshed into passive vehicles, index providers have had to alter their benchmarks to maximize liquidity and create enough scale to help index fund managers accommodate those massive asset flows. We believe these maneuvers can change the economic characteristics of the indexes versus the markets they were originally meant to represent—making indexing more active than meets the eye.

Free-Float Adjustment. Rather than track an entire market, indexes often represent smaller investible universes that only include shares considered by index providers to be readily available for trading. This so-called free float often excludes shares held by certain "strategic" investor groups, such as company insiders, governments and family trusts, which are assumed to trade far less frequently. As more assets have poured into index strategies, index providers have made more free-float adjustments within their benchmarks to enhance liquidity and promote scale. But this free-float adjustment has also reduced investors' exposure to certain companies, and likely reduced returns by 10 – 20 basis points per year across developed and emerging markets.

Stock Selection. In addition, index providers make ongoing choices about which companies to include—another form of "active" decision-making that can contribute to opportunity costs for investors.

The first cost arises because excluding certain companies from an index effectively shrinks the investible universe, which can lead to marginally more concentrated portfolios that have the potential to underperform the universe of all stocks. For example, index providers generally exclude smaller companies that can offer a long-term return premium for buy-and-hold investors. Since 1957, the large-cap S&P 500 index has underperformed the broader market of all stocks by about 20 basis points a year. However, the more representative Russell 3000 and the Wilshire 5000, have trailed by 10 – 20 basis points a year since 1984 and 1970, respectively. All told, we believe that limiting inclusion within indexes could reduce returns by another 10 – 20 basis points per year. Although these numbers sound small, the effect on compounding—and thus the accumulation of assets—can potentially be significant (see display at bottom left on page 18).

Potential Hidden Opportunity Costs of Indexation

Potentially
~35 bps
PER ANNUM

Opportunity Cost

FLOAT ADJUSTMENT	UNIVERSE SELECTION	INDEX ARBITRAGE
10-20 bps PER ANNUM	**10-20 bps** PER ANNUM	**0-10 bps** PER ANNUM

Source: Neuberger Berman. Bps refers to basis points.

Tracking error and arbitrage. Risks can also arise from short-term performance deviations, called tracking error, between an index fund and its benchmark. Driven by the differences in composition noted above, this can lead to short-term opportunity costs if one chooses the "sub-optimal" index. In addition, periodic changes in index composition can invite arbitrageurs to bet on (or against) the stocks that are added or removed from the index—adding to the cost of new purchases by the fund or reducing its sale price on the stocks that are removed. This has been estimated to cost index fund investors another 10 basis points per year in performance.

INDEX EXCLUSIONS CAN SACRIFICE RETURN

U.S. Broad Market vs. S&P 500 (Since Inception)

	Annual Rate of Return	Cumulative Return	Annualized Standard Dev
U.S. Broad Market	10.7%	85,532%	15.2%
S&P 500 Index	10.5%	75,595%	14.7%
Excess Return	0.2%	9,936%	0.4%

Source: FactSet, Kenneth French data library, as of July 2023. The U.S. broad market portfolio is represented by the Fama French Research Portfolio. Indexes are market-cap weighted. All figures rounded.

All told, we believe index fund managers' active decisions could potentially cost investors about 35 basis points per year.

OTHER ISSUES

While some may argue that roughly 35 basis points is worth the convenience of investing in (nearly) the entire market, especially when many active managers struggle to beat their index-based benchmarks net of fees, we believe there are other important considerations when implementing indexation within portfolios.

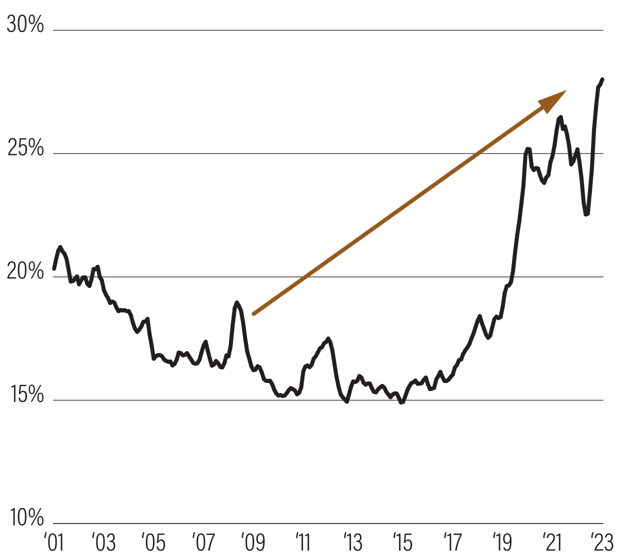
Eroding fiduciary stewardship. Just five large institutional investors now passively hold a significant percentage of stocks within the S&P 500 index—32% of the overall index, and as much as 35% in the case of real estate and 29% for utilities. As a result, significant voting power now resides with a few players who, in our view, are not effectively equipped to weigh in on crucial issues, like capital allocation decisions, board member composition and executive compensation, to name a few. In contrast, we believe that engagement, including the use of proxies, is a crucial part of our remit as active managers. Early dialogue can help steer companies toward better decisions, while proxy voting can help drive change that benefits shareholders.

Rising index concentration. Many index funds are tied to market-cap-weighted indexes, increasing so-called concentration risk as companies with larger market caps come to dominate the performance of the indexes, as is the case today (see display on page 19). This makes passive investors particularly vulnerable to drawdowns involving high-valuation "favorite" stocks, as has happened periodically over time, for example, in the wake of the "dot-com" bubble of two decades ago.

"We believe active management can allow investors to seek attractive risk-adjusted returns while expressing an expanding array of preferences in ways that modern indexing can't."

INDEX CONCENTRATION HAS WORSENED

Largest 1% of Companies Within the Russell 1000 Index (by Weighting)



Source: Neuberger Berman research, MSCI and FactSet, as of August 2023.

Limited flexibility. We believe active management can allow investors to seek attractive risk-adjusted returns while expressing an expanding array of preferences—including regarding environmental, social and governance issues—in ways that modern indexing can't. We think investors should ask themselves why they should pay an index fund even modest fees to make active decisions that may not ultimately reflect their fundamental world views.

Price-discovery breakdown. Finally, we believe passive strategies ultimately require properly functioning capital markets driven by true price discovery between active market participants. At some tipping point, in our view, that price-discovery mechanism has the potential to break down.

STRIKING THE RIGHT BALANCE

As noted, index creators make a variety of active decisions that can curb the performance of their indexes at passive investors' expense. Moreover, we think that indexation, taken to its logical extreme, has the potential to disrupt the fundamental relationship between value and price.

How, then, to navigate the mounting tension between the desire for low fees and the market's structural need for "price discovery"? We believe that investors can and should strike a thoughtful balance between passive and active allocations—not only to address what we believe to be indexation's hidden opportunity costs, but also to help preserve the underlying stability of the capital markets.

Moreover, while passive investing is clearly here to stay, we would encourage investors to actively educate themselves on the mechanics and potential ramifications of indexation, and the value of active management—because it never hurts to study the fine print.

JULIA CHU Head of Philanthropy and Family Governance Advisory

Constructing Your Philanthropic Portfolio

A FRAMEWORK FOR DEPLOYING CAPITAL TO NONPROFITS CAN HELP MAXIMIZE YOUR IMPACT.

With the approach of peak charitable giving season, you have the opportunity to plan your donations systematically. It's common to respond to incoming requests and specific events, including annual appeals and natural disasters. But this reactive approach, while understandable and common, may not provide the long-term impact that could result from a more deliberate and strategic process.

Interestingly, investors who seek to maximize the return on their financial investments through a disciplined process may approach charitable giving without any framework or consistent vetting method. Yet the "returns" they seek in terms of positive community impact may be no less important or meaningful to them.

In the following pages, we provide questions you can consider to inform your philanthropic efforts, and then offer guidance on building your nonprofit portfolio.

Questions to Ask

WHY ARE YOU GIVING?

Philanthropy may arise from a range of motivations, including faith, a formative experience, tax benefits and desire to contribute to society. These motivations may coexist in different measure at various life stages, and often reflect the donor's core personal values. Understanding your long-term vision of success will help prioritize and structure your giving in seeking to realize your charitable goals.

WHO WILL PARTICIPATE?

While philanthropy may begin as a solo endeavor, it may eventually engage spouses, children and grandchildren. It may also involve trusted nonfamily member advisors or subject matter experts to help guide and advance your philanthropic intent. Considering your successors in the event of death or incapacity is also critical to mitigate disruption to your charitable giving. Regardless of whom you choose to involve, sharing your philanthropic purpose will be instrumental in guiding collective decisions and expectations in the future.

HOW WILL YOU MAKE DECISIONS?

Philanthropy often seems daunting, and it can be hard to know where to begin. We all have a unique giving philosophy, and understanding yours can guide your priorities and decision-making.

Core values may inform your approach. For instance, those who especially value integrity in personal and professional relationships may want to see this quality in charities, via transparency in the use of funds, and follow-through on particular projects. Some who value diversity may seek to support nonprofit leaders who have historically lacked access to capital and connections. Others may seek evidence and data in their choices. Understanding what drives your decisions will help clarify the primary themes in your philanthropic investing.

Procedure matters as well, especially when more family members are involved in your process. Establishing voting rules, due diligence standards, individual versus group grantmaking opportunities and more can enable collective action and minimize conflict.

WHAT DO YOU WANT TO ACCOMPLISH?

After you've established the why, who and how of your philanthropic decision-making, you have the basis to set short- and long-term objectives for deploying your capital. With so many worthy causes out there, you need to decide what to focus on: What problems do you wish to solve? What organizations do you feel connected to? What issues, topics or areas spark your passion?

As with any business plan, understanding the current landscape of your focus area is important to build on the experience of others and avoid duplication of efforts and resources. Once you find areas of unmet opportunity, its useful to develop a series of milestones for your philanthropy. These indicators may consist of precise quantitative goals or more general targets, and can be adjusted over time. The point is to foster discipline and accountability in charting your journey.

WHERE WILL YOU INVEST?

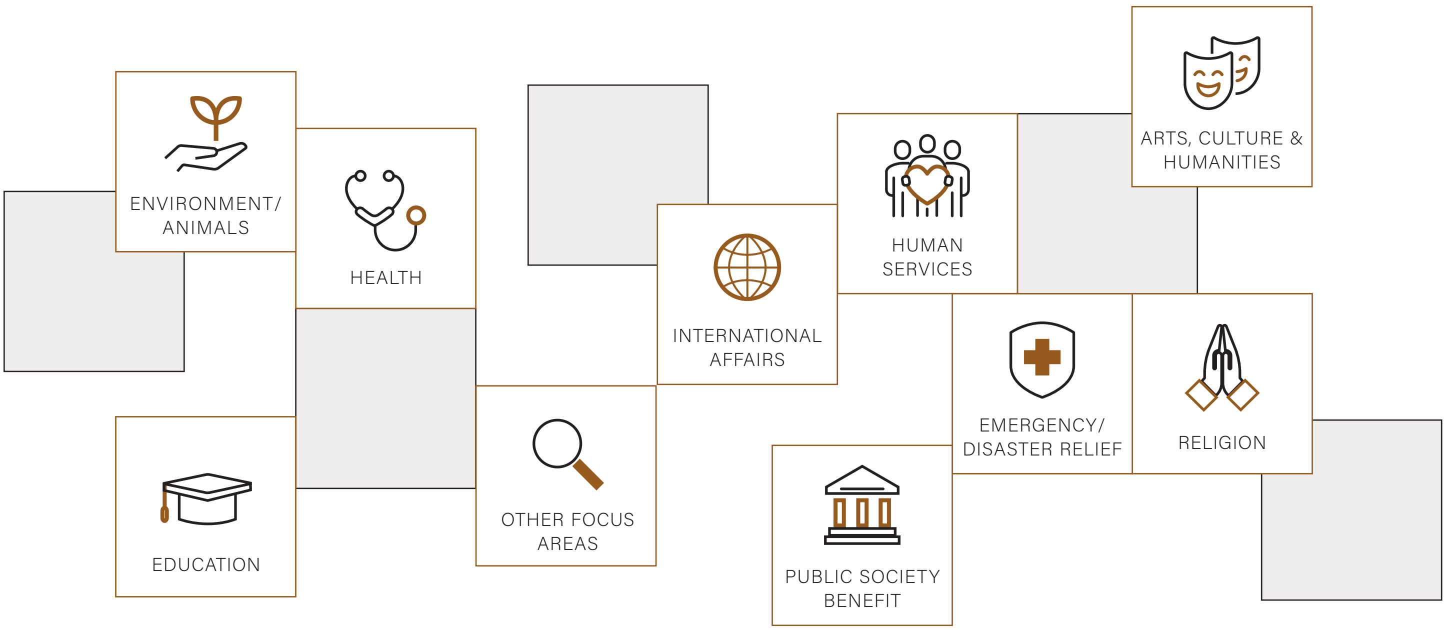
As financial portfolios may hold investments in companies based both in the U.S. and in foreign markets, you have the option to give to charities based locally, nationally or globally. Understanding your desired geographic footprint can help you prioritize your energy and capital.

WHEN WILL YOU INVEST?

Since philanthropy involves spending, determining your annual giving budget and the time horizon of your charitable vehicle helps to solidify the framework of your philanthropy. Your advisors can help ascertain your desired annual charitable giving budget, in light of your other spending priorities, both in current and future years.

As for giving primarily during life or upon death, this decision also affects the amount of your annual charitable spending. Providing for philanthropic funds after death raises the planning question of duration: The selected time horizon of a foundation, for instance, can span a limited number of years or extend into perpetuity. As with a personal portfolio, your philanthropic time horizon informs investment strategy. While your preference may change over time, understanding your desired timing can help optimize portfolio growth in relation to the timing of its deployment.

Targeting Your Desired Philanthropic Allocation



Constructing Your Nonprofit Portfolio

SECTOR ALLOCATION

When investing for financial return, asset allocation is crucial to portfolio construction. Similarly, philanthropic objectives can determine the makeup of your charitable giving. You may have philanthropic capital in your personal accounts, a donor advised fund, a private foundation or a combination of all three. Whether these are viewed separately or together, you can determine your desired sector allocation proactively, while allowing for flexible "emergency" giving should the need arise. Naturally, your allocation can evolve over time to reflect your priorities.

RISK PROFILE

Depending on your giving philosophy, the types of institutions you support may vary. Some donors may prefer larger nonprofits with a long track record and deep expertise. For such grants, "returns" are predictable and consistent, for example through the number of meals served, or patients treated. They may have significant resources, but also have a significant budget to maintain operations.

In contrast, start-up organizations may appeal to those who value innovation, albeit with greater risk of failure. Your risk preference may depend on the cause. For local impact, you may wish to support a new grass-roots organization, but for global emergency relief, you may prefer an organization that has responded quickly to disasters over time. Knowing your risk profile can help you align your capital efficiently within your sectors of focus.

ACTIVE VS. PASSIVE

Investors often consider the "active-versus-passive" decision by assessing what areas of the markets may be more suited to each approach. In philanthropy, donors can similarly choose charities on an active or passive basis—both of

Nonprofit Factors to Explore

PROGRAM TRACK RECORD. Nonprofit organizations may share their activity and results through an annual report or updates on their websites.

LEADERSHIP STABILITY AND REPUTATION. Recent press coverage can highlight any awards, recognition or scandals that may affirm or question leadership capacity and integrity.

FINANCIAL HEALTH. Several online platforms assess nonprofit financial health, and may serve as a starting point for your efforts. GiveWell and Charity Navigator are two examples.

DATA AND EVIDENCE. Your research (e.g., on platforms including Issue Lab and Giving Compass) can yield critical intel in assessing charities.

INVESTMENTS BY PEERS. Leveraging the research of large funders in your area of interest can accelerate your due diligence. Foundations have specialized professional staff who thoroughly vet nonprofit organizations and often list their grantees online.

which can serve an important purpose. Passive gifts leave the details to the organization you have funded. Active philanthropic involvement, in contrast, may entail ongoing dialogue with nonprofit leadership to assess its needs and progress. An active approach may involve serving as an advocate for the organization, as well as publicly announcing matching or challenge grants to attract further support; and an active donor may serve on the organization's board, assuming a fiduciary duty for its health and substantiality. You may wish to take a combined approach, depending on the cause. Clarifying your preference helps to prioritize not just your capital, but your valuable time and effort.

DUE DILIGENCE

Once you've determined your sector allocation, risk profile and investing style, the next step in constructing your philanthropic portfolio entails due diligence of potential nonprofit grantees. As in financial investing, you can evaluate organizations across an array of factors, including track record, leadership, financial health and more (see "Nonprofit 'Factors' to Explore," at left).

MONITORING

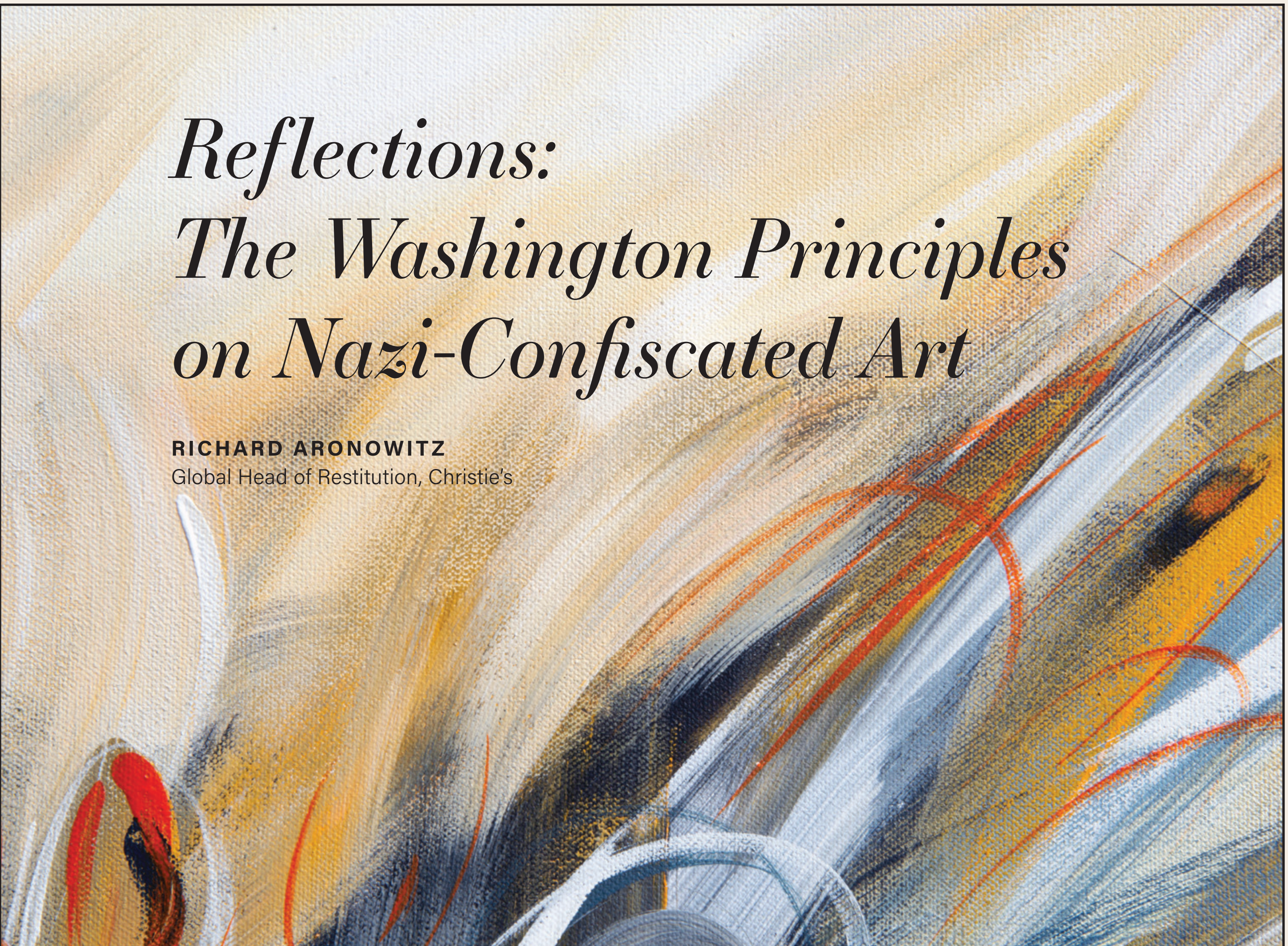
Effective philanthropy requires ongoing monitoring of your nonprofit portfolio, which may include reading organizations' annual reports for budgets, accomplishments and plans; following them on social media; scanning the "news" sections on their websites (and of similar organizations) and signing up for their e-newsletters; and attending organization-sponsored events. If you make a major gift, consider meeting with the nonprofit to get updates directly.

A Systematic Approach

Traditional investing and philanthropy can share important similarities—particularly in relation to allocation, research and follow-through. In both cases, organized effort can produce better results, one in the form of monetary returns and the other in terms of impact on the broader world. Although the evolution from ad hoc giving to a philanthropic portfolio involves some thought and effort, no one should be intimidated. With help from your advisors, it can be meaningful and ultimately rewarding process.

Reflections: The Washington Principles on Nazi-Confiscated Art

RICHARD ARONOWITZ
Global Head of Restitution, Christie's



Over the course of 2023, Christie's auction house has presented a series of programs across the globe on the impacts of the Washington Principles on Nazi-Confiscated Art, a nonbinding, ethically driven code introduced a quarter century ago to address the disposition of art stolen under the Nazi regime. In this column, Richard Aronowitz, Global Head of Restitution at Christie's, reflects on the Principles' profound impact on the art world.

> *"The approach taken to righting the historical wrongs of the looting and forced sale of art and cultural valuables is necessarily a pragmatic one, but is also underpinned by a deeply felt need to do the right thing."*

The year 2023 marks a significant milestone in the restitution of art and cultural property that was lost, looted, confiscated or sold under duress in Nazi-controlled Europe between 1933 and 1945. It has been 25 years since the Washington Conference on Holocaust-Era Assets, a gathering at the U.S. Department of State and at the United States Holocaust Memorial Museum in Washington, D.C. to which 44 countries sent representatives, cultural ambassadors and thought leaders to deliver statements on their countries' then-current position on unrecovered Nazi loot.

In a major initiative led by Ambassador Stuart Eizenstat, at the time the United States Under Secretary for Economic, Business and Agricultural Affairs, who had convened the conference, one of the key achievements and lasting legacies of the event was the drafting and publication of the Washington Principles on Nazi-Confiscated Art. The Principles are a set of 11 nonbinding, moral-ethical codes that serve today as the bedrock of work by provenance researchers and restitution specialists around the world in the arena of unrecovered 1933 – 1945 losses, whether at museums or in the international art market.

Principle no. 1 states that "Art that had been confiscated by the Nazis and not subsequently restituted should be identified," Principle no. 3 says that "Resources and personnel should be made available to facilitate the identification of all art that had been confiscated by the Nazis and not subsequently restituted," and Principle no. 5 proposes that "Every effort should be made to publicize art that is found to have been confiscated by the Nazis and not subsequently restituted in order to locate its pre-War owners or their heirs." There is, then, nothing ambiguous about this language, and 25 years ago the Principles made explicit the new standards of research to which the international art trade should be aspiring.

One of the key phrases that is embedded in the Principles is that of "just and fair solutions" when discussing possible remedies that can be applied once a work that was lost, looted or sold under duress during the Third Reich is discovered on the wall of a museum or emerges on the art market. Of course, "just and fair" is a phrase that is open to myriad interpretations, none of which can be easily calibrated or defined in law. Fair to whom: to the current owner as well as to the claimants? How exactly do we measure what is just?

THE PRINCIPLES IN ACTION

In practice, however, when the team of provenance researchers within the Restitution Department at Christie's discovers that a work consigned for sale has an unresolved Nazi-era ownership taint, acting as neutral intermediaries and using the Principles as a template, we try to initiate a dialogue between our consignor—almost always a good-faith owner to whom the news comes often as a tremendous shock—and the descendants of the family that lost possession of the work during the Third Reich.

The moral-ethical force of the Principles provides the framework for us to initiate such a dialogue, which aims to achieve a settlement between the parties that often results in the sale of the work pursuant to a joint written settlement agreement allowing for the sharing of the sale proceeds and, through this, the lifting of the ownership taint.

The approach taken to righting the historical wrongs of the looting and forced sale of art and cultural valuables that took place over 78 years ago, then, is necessarily a pragmatic one, but is also underpinned by a deeply felt need to do the right thing.

The Principles and their goal of "just and fair" solutions allows the Restitution team, working closely with our expert departments, to do that by first conducting research into the ownership history of the works that Christie's intends to sell, and then by trying to initiate dialogue that leads to settlements if an unresolved taint is discovered.

BROADER IMPACTS

It's important to note that, before 1998, any auction house or art dealer could sell with near-complete impunity and any museum could hold undisturbed in its collections a work that was lost during the Third Reich and that remained unrecovered after 1945, as there was no mechanism—beyond costly, complex, time-consuming litigation in the very few jurisdictions where that was even possible—for families to make a claim to a work that had been lost or sold under duress.

Following the conclusion of the Washington Conference, things gradually began to change. Awareness of the looting of art and cultural property from Jews in Nazi Europe slowly began to grow, supported by the increased publication of historical works on the subject. No longer was it plausible simply to plead ignorance on the subject. As such, the international art world increasingly sought to identify "looted" works and to rectify the injustices they represent.

Without the Principles, and without the Washington Conference that led to them under the inspired stewardship of Ambassador Eizenstat, none of this would be possible; and historical wrongs would have continued, often entirely undetected and unrecognized, through the generations.

Richard Aronowitz began his career in the art world as a furniture porter at Bonhams in 1993, then joined Sotheby's as an Impressionist & Modern Art specialist in 1997, before leaving to become Director of the Ben Uri Gallery in 2003. He rejoined Sotheby's as European Head of Restitution in 2006, then moved to Christie's in March 2022 as Global Head of Restitution. Richard is the author of the novels *Five Amber Beads, It's Just the Beating of my Heart, An American Decade* and a book of poetry, *Life Lessons.*

Highlights 4Q 2023

FROM THE ASSET ALLOCATION COMMITTEE

We remain cautious in a "higher-for-longer" rate environment where economic growth could slow, favoring assets and issuers that can better withstand economic and market pressures.

EQUITIES

The recent upward move in government bond yields could be a challenge for equity markets. Although maintaining our 12-month neutral view on equities, we favor defensive positioning in large-capitalization stocks and a bias toward quality; regionally, we prefer the U.S., given its consumption-driven economy, and Japan, in light of its attractive valuations and corporate improvements. The manufacturing economies of Europe and China are less appealing.

FIXED INCOME

The recent surge in yields has made us more positive on developed-market government bonds, although concerns about debt sustainability and the risk of higher long-term rates inform our preference for short to intermediate maturities. We favor investment grade credit and cash, and within high yield are biased toward quality. In emerging markets, sovereigns appear more attractive than corporates, which face various headwinds.

ALTERNATIVES

Although commodities' long-term supply and demand picture appears positive, the currently softer growth outlook is a near-term headwind. In private markets, we see potential in liquidity-providing strategies such as private debt, as well as private equity secondaries and co-investments. We favor hedged strategies with uncorrelated returns and/or the ability to capitalize on market volatility.

All views are over the next 12 months unless otherwise stated. See disclosures at the end of this publication, which include additional information regarding the Asset Allocation Committee and the views expressed.

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PRIVATE WEALTH

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