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Investment Quarterly
Summer 2021

NEUBERGER BERMAN

Entering New Territory

INVESTORS ARE GRAPPLING WITH A UNIQUE RECOVERY AND ITS IMPLICATIONS.

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JOHN F. GEER, JR., CFP®
Managing Editor

Looking for Balance

The world is recovering, but that doesn't mean investing is now a walk in the park.

For many Americans, conditions have improved markedly over the past 12 months, given the success of vaccinations, reacceleration of economic activity and a gradual return to normalcy in day-to-day life. For much of that time, the investment environment has also been fairly benign, as central banks and government stimulus, combined with business recovery, have helped support markets and reward many who avoided panic and "stayed the course" in their portfolios.

Ironically, as noted in our cover article, better real-world dynamics have in some ways heightened investment complexity, with surging growth contributing to inflationary pressures and fears about Federal Reserve policy shifts, even as key U.S. equity indices have reached all-time highs. Of course, we will take normalcy over lockdowns any day of the week, but as investors we have to be mindful of the pitfalls that may exist even in the sunniest of scenarios.

Consistent with our *Solving for 2021* outlook (published in November and updated on page 6), we remain constructive on equities overall as the economy recovers, and see the recent surge in growth shares, following significant outperformance of more cyclical and value-oriented stocks earlier this year, as supportive of maintaining portfolio diversification across style factors. Although their prospects are uncertain, current federal spending and tax proposals reinforce our emphasis on tax efficiency, while low yields and higher inflation underline the appeal of flexible approaches to generating potential income.

This issue of *Investment Quarterly* reflects our multifaceted approach, with topics ranging from the investment landscape, private equity, and environmental, social and governance investment considerations in municipal investing, to nonprofit board service and estate planning in advance of legislative change. I hope you enjoy the content and find it useful.

On an organizational note, I am delighted to share a recent addition to our team: Greg Khost has joined as the Head of Business Development for Private Wealth Management. Over the past 30 years, Greg has helped guide investment and advisory teams at leading firms in creating bespoke solutions for private clients, and I look forward to his leadership as we seek to expand our teams and enhance our services to meet your individual needs.

Finally, one happy byproduct of the rapid reopening has been the ability to venture back into the office, albeit gradually. All of our locations across the U.S. are now open. However, we are embracing the lessons of the past year and look forward to continuing to offer both in-person and virtual engagement opportunities.

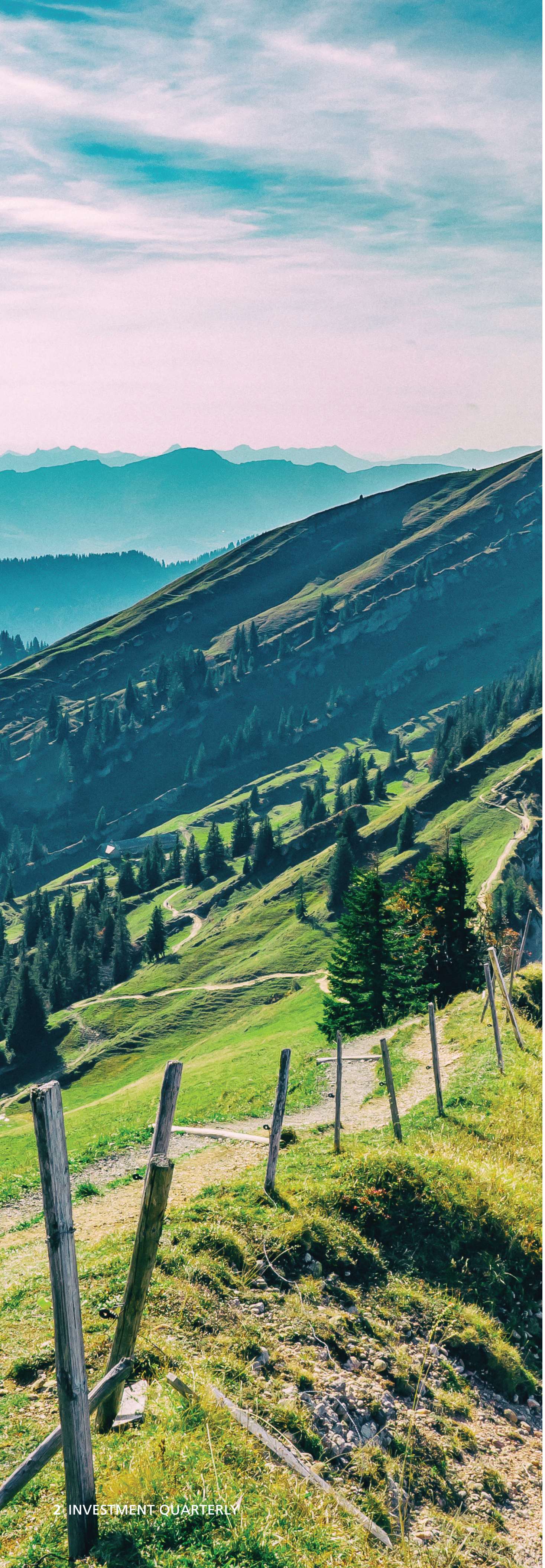
We hope to see you soon. In the meantime, please do not hesitate to reach out to your Neuberger Berman team with questions about the markets, your investments, or planning strategies in the current environment.

Sincerely,

Stephanie B. Luedke

STEPHANIE B. LUEDKE, CFA
Head of Private Wealth Management

Market Focus



Entering New Territory

Investors are grappling with a unique recovery and its implications.

JOSEPH V. AMATO
President and Chief Investment Officer—Equities

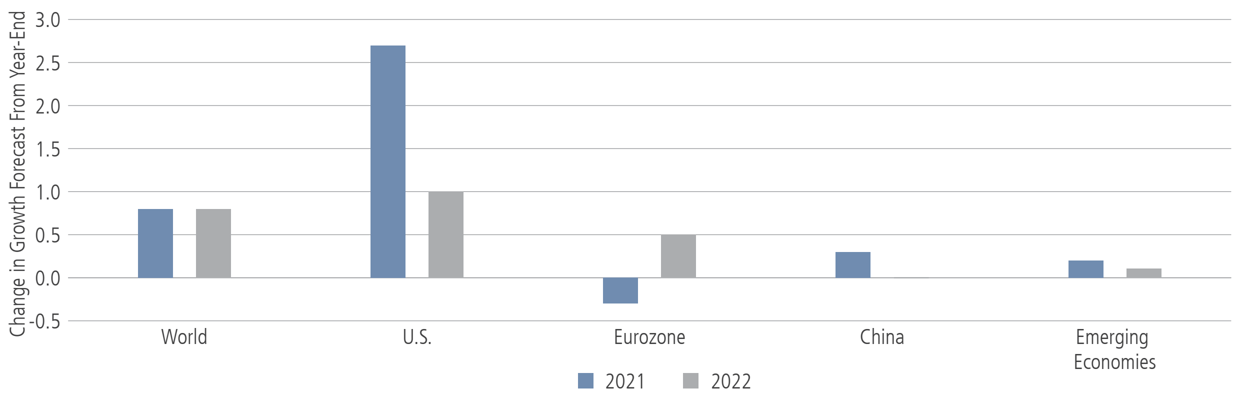
Coming off a year of pandemic, economic contraction, market collapse and resurgence, we expected 2021 to be anything but typical, with hope for new traction against COVID-19, and a reopening and economic recovery like none seen before. Indeed, this year has not disappointed, as widespread vaccine distribution has allowed the emergence from lockdowns, which has contributed to a surge in economic activity and an impressive advance in risk assets. That said, the current environment carries multiple complexities: Massive stimulus and pent-up demand have contributed to fears of higher inflation, bringing Federal Reserve policy back into focus, while the potential for infrastructure spending and new taxes has added to market uncertainty. In short, investors are entering what may be especially unfamiliar terrain, requiring attention to portfolio positioning.

RAPID GROWTH, CYCLICAL STRENGTH

The collective release of the population from their apartments and homes has led to extraordinary economic growth so far this year. Moving from depressed 2020 levels, U.S. GDP shot up 6.4% in the first quarter and an estimated 9% in the second, with increasing confidence toward around 7% for all of 2021—potentially the country's best annual economic performance in decades. The Purchasing Managers' Indices (PMI) measuring manufacturing and services activity have also been elevated, at around 61 and 60, respectively, for June. (Figures above 50 reflect expansion.) Meanwhile, equity markets have managed to work through pockets of volatility to achieve records, with the S&P 500 gaining about 15% year-to-date through June 30, largely driven by cyclical and value stocks that have historically benefited from the early stages of expansion.

LED BY THE U.S., GLOBAL GROWTH EXPECTATIONS HAVE ACCELERATED

Change in Growth Forecast From Year-End (Percentage Points)



Source: Bloomberg. Consensus growth estimates as of June 22, 2021. For illustrative purposes only. Nothing herein constitutes a prediction of future economic or market environments. Due to a variety of factors, actual events, including the characteristic of economic or market environments, may vary significantly from any views expressed. **Past performance is no guarantee of future results.**

FOCUS ON INFLATION AND THE FED

Investors are always looking ahead, and the dominant financial story of recent months has been inflation. Largely a non-issue since the 1970s, price inflation has recently surged in large part due to basic supply/demand imbalances, with suppliers unprepared to meet the ferocious jump in reopening-related demand, particularly for durable goods. Special issues associated with the pandemic have also been a factor, including supply chain glitches, component and labor shortages, and shifting demand preferences in the wake of the pandemic. Oil prices, briefly priced below $20 early last year, have swelled above $60, while many other commodities have also surged, even if retreating somewhat lately.

The Treasury market signaled new concern about inflation early in the year. The 10-year yield, which had been gradually creeping up since mid-2020, more than doubled to 1.75% in the first quarter before easing to its recent level of around 1.30% in mid-July. Meanwhile, a range of pressures has pushed further acceleration in prices, lifting the Consumer Price Index (CPI) to 5.4% in June—its highest rate in 13 years—while less volatile core CPI (excluding energy and food) also reached extremes (see display).

INFLATION HAS BEEN FLASHING RED

Core CPI and Components

Source: Bloomberg, data through June 2021. For illustrative purposes only. Nothing herein constitutes a prediction of future economic or market environments. Due to a variety of factors, actual events, including the characteristic of economic or market environments may vary significantly from any views expressed. **Past performance is no guarantee of future results.**

For months, the Federal Reserve insisted that the current spike was largely temporary, driven by frictions associated with reopening that would ultimately fade. Having reset its policy framework last year, it was prepared to allow some overheating to safeguard recovery, with the understanding that price increases would retreat to its long-term target of 2%. However, by their June meeting, board members were changing their tune—acknowledging that higher inflation could persist longer than expected. In a pivot to more "hawkish" messaging, they began to contemplate when to start reducing their bond purchases (currently $120 billion per month in Treasuries and mortgages) and accelerated their forecasts for interest rate hikes, with two potential increases now likely in 2023.

The Fed remains committed to its narrative of "transitory" inflationary pressures, which it believes could start easing next year. Interestingly, bond investors reacted little to the recent developments, perhaps because they had already been priced in by the markets. For our part, we agree that recent pressures are largely transitory, and believe that inflation levels are likely to retreat from extremes as pandemic-related bottlenecks and labor issues ease, although price increases are likely to settle into a range that is above recent norms.

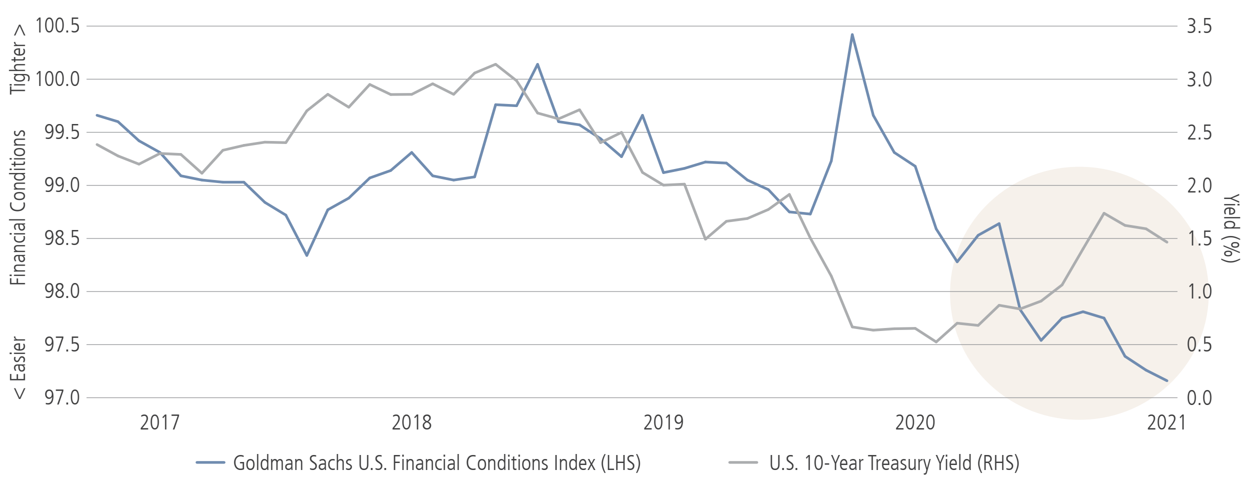
Admittedly, the Fed is in a tough spot in seeking to achieve its dual mandate of price stability and full employment. The jobs recovery since reopening has been slower than expected, with the unemployment rate hovering at around 6% despite a record 9.8 million available positions.[1] Debate continues around the reasons for this gap, which may be a combination of workers' anxiety about exposure to COVID-19, difficulty in finding childcare, and generous extended unemployment payments, which have created a disincentive to seeking work. Businesses in reopening-sensitive sectors like travel and leisure have had trouble recruiting for service positions, which has led to meaningful wage increases for low-wage jobs—something that is adding to inflation pressures. However, longer-term structural issues may also be at play, with many older workers choosing to retire and the economy becoming more digital, which has led to further automation and may require skills that many workers simply do not have. If these trends have raised the level of "full" employment, that might shorten the path to where the central bank would believe it appropriate to tighten monetary conditions.

GAUGING GROWTH, EARNINGS AND MARKET PERFORMANCE

A key factor in the Fed's calculus and market prospects more generally is the likely path of growth moving forward. Although the economy is hitting new records, we believe that the impact of reopening and massive fiscal stimulus is likely to fade, creating an overhang that reduces growth to about 3.8% next year and a closer-to-trend 2.5% in 2023 (both consensus). This provides some support for the Fed's position on inflation, but we believe it also allows for continued optimism around stocks over the next 12 months, supported by loose financial conditions (see below) and strong corporate profits, as S&P 500 companies are expected to see a 37% increase in earnings this year and a 12% increase in 2022.

In terms of positioning, we are comfortable with an emphasis on value and cyclical shares (particularly in less expensive non-U.S. markets—see display), but at the same time we believe that price

FINANCIAL CONDITIONS REMAIN LOOSE EVEN WITH HIGHER TREASURY YIELDS



Source: Bloomberg. Data as of June 30, 2021. For illustrative purposes only. Nothing herein constitutes a prediction of future economic or market environments. Due to a variety of factors, actual events, including the characteristic of economic or market environments may vary significantly from any views expressed. **Past performance is no guarantee of future results.**

[1] As of June 30, 2021.

volatility could increase given renewed monetary uncertainty. In addition, potential from economic slowing from post-COVID highs suggests the benefit of some exposure to more defensive growth stocks, which have typically performed better toward the middle stages of recovery. Longer term, we also favor thematic opportunities tied to the digital economy, which we believe will become more pervasive in coming years. (Read our *Solving for 2021* update on page 6 for more details on these ideas.)

Looking at fixed income, the second half of the year could prove more turbulent as investors watch inflation numbers and the reaction of central banks. In general, yields remain quite low, while strong economic fundamentals have reduced the additional income provided by non-Treasuries. This reinforces the importance of casting a wide net to find opportunities, and to identify individual securities that have been mispriced by the market. Given prospects for tax increases, exposure to municipals remains a key aspect of high net worth portfolios. As always, we believe that alternative investments can help with issues of return potential and income generation, depending on the nature of individual goals and objectives.

OTHER RISKS AND ISSUES

Although inflation has been the focus of recent attention, it's important to keep in mind other key risks. One important remaining risk is the pandemic: Although the developed world has made great progress in inoculating its populations, many poorer countries are lagging behind and continue to see elevated infection rates. Meanwhile, the spread of variants is a threat that reinforces the importance of continued success on vaccination. That said, the overall path is encouraging, and we anticipate increasing global control of the virus as we move deeper into 2021.

Also worth noting is the scope of potential U.S. spending and tax increases. As I write, the President and legislators continue to consider areas of common ground in traditional infrastructure, and much more partisan goals around "human" infrastructure and climate change, paid for with new taxes on corporations and wealthier Americans. Given the Democrats' narrow majorities, the use of reconciliation to avoid the Senate filibuster appears likely, and, even then, moderates may not get behind the various tax hikes being proposed. Still, it seems prudent to expect some increases, which could have a negative marginal impact on economic growth and earnings down the road.

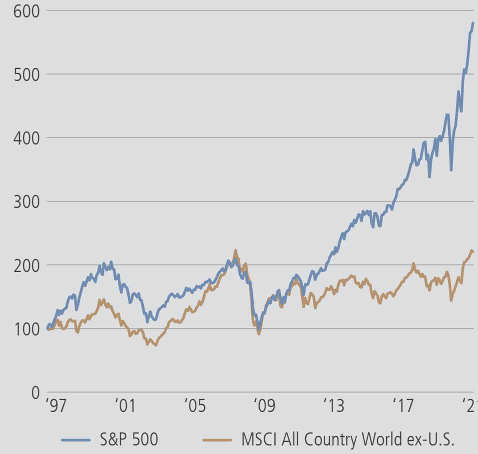
Finally, I would add geopolitics as a current worry that may not get enough attention. One might have thought that the sunset of a combative U.S. administration would bring an easing of tensions, and it's true that the U.S. has rejoined various multilateral organizations and reengaged on climate. However, multiple tests remain, from the intensifying rivalry with China, to Russian cyberattacks, to Iranian and North Korean nuclear ambitions, to the security of the southern border. Of these, our relationship with China has particular potential to reshape the business landscape; in their research, our analysts routinely assess company positioning in relation to China and supply chains.

PARTING THOUGHTS

Although the current landscape may feel a bit unusual to many investors, it's important to keep the challenges we face in context. Eighteen months ago, we were about to enter a nearly unprecedented health crisis that caused widespread misery and economic dislocation. Today, we have generally emerged from our households, the economy is strong, the stock market is near record levels and the virus appears to be on the run. Inflation, taxes, supply shortages, national rivalries—these are all problems that ebb and flow over time. What matters is the path forward, which, despite some uncertainty, remains reasonably constructive, in our view.

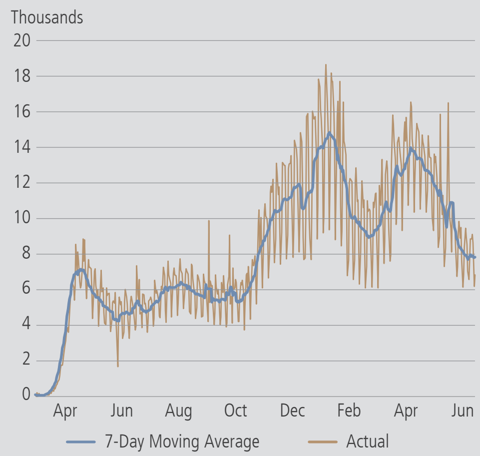
See disclosures at the end of this publication, which are an important part of this article.

MORE VALUE MAY BE AVAILABLE OVERSEAS



Source: Bloomberg. Data through June 30, 2021. Indexed at 100 as of January 1, 1997. For illustrative purposes only. Nothing herein constitutes a prediction of future economic or market environments. Due to a variety of factors, actual events, including the characteristic of economic or market environments may vary significantly from any views expressed. Indexes are unmanaged and are not available for direct investment. Investing entails risks, including possible loss of principal. **Past performance is no guarantee of future results.**

GLOBAL COVID-19 DAILY FATALITIES



Source: Goldman Sachs, as of June 30, 2021.

SOLVING FOR 2021

Ten for 2021: Midyear Update

Late in 2020, Neuberger Berman's senior investment leaders identified 10 major themes they anticipated would guide investment and planning decisions in 2021. Below, they assess how these themes are developing as we pass midyear.

JOSEPH V. AMATO, *President and Chief Investment Officer—Equities*
ERIK L. KNUTZEN, CFA, CAIA, *Chief Investment Officer—Multi-Asset Class*
BRAD TANK, *Chief Investment Officer—Fixed Income*
ANTHONY D. TUTRONE, *Global Head of Alternatives*

1 ECONOMIC RECOVERY WITH LOW INFLATION

What we said: The pandemic created a deep recession that has set a low base from which to rebound. We now anticipate a resumption of dynamics that existed prior to the virus-driven shutdowns, with strong growth in GDP and corporate earnings, higher but modest initial inflation and accommodative Federal Reserve policy. While unemployment should continue to decline next year, higher inflation is unlikely until 2022 or beyond, even as the Fed continues along its dovish path.

What we've seen: The economic recovery has been exceptionally robust as reopening has gathered steam on the back of successful vaccine efforts and extraordinary stimulus. Various data are "running hot," including industrial and service activity. Consumer inflation rose 5.4% in June, while a disconnect emerged between unemployment and available positions, and companies struggled with supply chain bottlenecks. Amid debate as to whether pricing pressures are transitory or something more permanent, we fall solidly into the "transitory" camp: As the pivot to reopening progresses, we expect to see pricing pressures ease, although perhaps to somewhat higher levels than we once anticipated.

2 POPULISM IS HERE TO STAY... TAX EFFICIENCY AND PLANNING TAKE CENTER STAGE

What we said: The election of 2020 does not mark the end of political populism or its causes, in our view. That probably means continued political volatility and additional fiscal stimulus beyond the immediate crisis. This suggests an upward bias in taxation over time, regardless of who is in political control. We believe a key structural "hinge" to moving through the doorway to the 2020s is tax-efficient investing—as well as effective tax planning. Though a divided government may make near-term changes to tax laws less likely, we believe individuals should focus on long-term tax-efficient portfolio strategies, and capitalize on currently available planning techniques.

What we've seen: The Biden administration has introduced massive stimulus proposals seeking to transform the economy and levy new taxes on the wealthy. But with Democrats' narrow legislative majorities and hesitancy on the part of key moderates, chances of passing the entire agenda appear remote. Still, the possibility of change has renewed attention on tax efficiency across investment portfolios and estate planning strategies. Given likely budgetary pressures moving forward, we anticipate that regardless of the fate of current proposals, taxes will remain at center stage for some time. Maintaining taxes as a key element of the planning process could be essential in the years ahead.

WE ANTICIPATE THAT DIGITIZATION WILL CONTINUE TO SPREAD ACROSS THE ECONOMY, CHANGING HOW WE LIVE AND DO BUSINESS. IN OUR VIEW, INVESTORS SHOULD SEEK EXPOSURE TO THESE TRENDS TO CAPITALIZE ON THE OPPORTUNITIES THEY PRESENT.

3 ACCELERATED DIGITAL TRANSFORMATION PUTS DOWN ROOTS

What we said: During the coronavirus crisis, consumers and businesses have embraced working, shopping and accessing services from home, making the business case for digitalization and automation in factories, warehouses, offices and homes stronger than ever. Some unwinding may take place once the pandemic eases, but in our view the world of 5G connectivity, the Internet of Things and cloud computing is here to stay.

What we've seen: The digital transformation of the economy shows little sign of slowing. According to Gartner, spending on cloud services is seeing double-digit growth, while desktop services could increase 70% this year.[1] Meanwhile, the global stock of robots used in smart factories could swell from 2.4 million in 2018 to 4 million in 2022,[2] as automation and artificial intelligence gain traction. Views on "work-from-home," however, appear mixed: Although many employers (and employees) anticipate maintaining hybrid arrangements, they recognize the social, training and collaborative benefits of being in the office.[3] Altogether, we anticipate that digitalization will continue to spread across the economy, changing how we live and do business. In our view, investors should seek exposure to these trends to capitalize on the opportunities they present.

4 SUSTAINABLE INVESTING GAINS MOMENTUM

What we said: The pandemic has helped expose glaring inequalities in society, in terms of health care, incomes and employment. As the world emerges from the crisis, we believe that governments, businesses and investors will increasingly seek to mitigate such issues, while redoubling efforts on climate change and corporate governance. More than ever, viewing investments through an Environmental, Social and Governance (ESG) lens will help identify material risks and opportunities, while providing a vehicle, where desired, to effectuate change.

What we've seen: Momentum around ESG issues continues to accelerate. The U.S. has reengaged on climate, rejoining the Paris Agreement and setting aggressive goals on carbon. Other countries, including China, have introduced long-term emissions targets. At the corporate level, business leaders have released science-based timelines to achieving net-zero emissions, and enhanced reporting on an array of issues. Racial equity has seen heightened focus, as companies have sought to enhance diversity at all levels. Finally, shareholder engagement has reached critical mass, as reflected in a very active proxy season. Morningstar reports that U.S. sustainable funds attracted nearly $21.5 billion in net inflows in the first quarter, or more than double the figure from a year earlier. We continue to believe that integrating material ESG factors into investment research can help drive performance over the long term.

[1] Source: Gartner, Forecast: Public Cloud Services, Worldwide, 2019 – 2025, 1Q21 Update.
[2] Source: International Federation of Robotics, 2020 World Robotics Report.
[3] Source: Deloitte, U.K. Workers: A Year in the Pandemic, April 19, 2021.

5 GLOBAL TRADE WARS TO EASE, BUT TENSIONS REMAIN WITH CHINA

What we said: Geopolitical uncertainty, economic nationalist populism and simple wage and cost convergence illustrate the pros and cons of our key trading relationships tied to China. As the U.S. shifts gears politically and economically in 2021, we expect one outcome to be the increased diversification and efficiency of supply chains; a variety of our trading partners (including China) stand to benefit. The ongoing transformation of supply chains will reduce companies' and industries' exposure to disruption risk, but at some cost to investors and consumers.

What we've seen: The U.S. has reengaged with the global community, rejoining a number of multilateral agreements and institutions. At the G7 meeting, President Biden emphasized cooperation with allies on climate and defense, and recently ended a long trade dispute over airplane manufacture. In contrast, elevated tensions with China remain on display, as the U.S. has sought to counter China's efforts to expand its political, military and technological influence; recent U.S. legislation dedicated funds to competition with China and banned exports to certain Chinese companies. Meanwhile, companies continued to reorient supply chains in light of geopolitical issues and vulnerability to crises, including future pandemics. In our view, the ability to address these challenges could be fundamental to value creation as we move forward.

6 THE HUNT FOR YIELD CONTINUES

What we said: As with every recession, the 2020 coronavirus downturn caused the difference in yields between U.S. Treasuries and other fixed income securities to widen. Rapid and substantial central bank intervention made this an exceptionally short-lived phenomenon, however, leaving investors with a complex mix of growth dynamics, and default and valuation risks. We think this demands a flexible, "go-anywhere" approach to fixed income investing, backed up by the ability to make relative value assessments across sectors, as well as broad expertise and nimble decision-making.

What we've seen: With high spending proposals and income tax increases anticipated for wealthier Americans, municipal bonds have seen strong demand this year despite rate pressures. Federal rescue dollars have helped municipalities, even as their financial picture has been surprisingly strong. Given current fiscal support and economic recovery, the credit environment for municipals has improved significantly. In terms of technical factors, mutual fund inflows are on a record pace even as the supply of tax-exempt bonds has remained manageable. That said, municipals have rallied dramatically this year, leading to relatively full valuations, and reinforcing the importance of security selection in looking for returns.

7 SPENDING AND TAX TRENDS POINT TO MUNICIPALS

What we said: Already large government deficits and debt loads have grown substantially, as authorities have sought to insulate industries and workers from economic dislocation. With a consensus favoring more stimulus, and pressure to spend more on health care, climate and the social safety net, we think it's only a matter of time before tax rates go up to pay for it all—reinforcing the role that creditworthy municipal bonds already play in generating after-tax yield and income.

What we've seen: With high spending proposals and income tax increases anticipated for wealthier Americans, municipal bonds have seen strong demand this year despite rate pressures. Federal rescue dollars have helped municipalities, even as their financial picture has been surprisingly strong. Given current fiscal support and economic recovery, the credit environment for munis has improved significantly. In terms of technical factors, mutual fund inflows are on a record pace even as the supply of tax-exempt bonds has remained manageable. In our view, the combination of growth and technicals has created a very favorable environment for credit investing in the municipal bond market.

8 GROWTH VS. VALUE: A POSSIBLE ROTATION ON THE HORIZON

What we said: As the economy works through the impact of COVID-19, we believe that there will be a cyclical recovery, and markets will likely experience a rotation back toward cyclical stocks similar to what we have seen sporadically this quarter on days where there has been particularly good news around vaccines. To date, this trend has not been sustained given the uncertainties associated with the ongoing spread of COVID-19 and the timing of vaccines, but likely will become more meaningful sometime in the coming year. That said, we ultimately believe the outlook for the U.S. economy will be characterized by low interest rates, low growth and low expected returns, which will be supportive of growth stocks. This calls for diversification and a balanced approach to equity style investing.

What we've seen: In the early months of the year, many cyclical and value stocks experienced an impressive rally over growth and defensive names. This was a function not only of explosive economic growth, but also sharply higher interest rates, which tend to dampen the market performance of companies whose earnings are anticipated far in the future. More recently, growth has surged in light of easing yields and shifting growth expectations. Although we aren't calling the end of the value "reopening trade," we believe these patterns reinforce the value of a diversified, balanced approach to portfolios as we look toward the middle innings of recovery.

9 SECULAR GROWTH AND THEMATIC OPPORTUNITIES FOR THE LONG TERM

What we said: In a low-growth world, secular growth stocks are likely to command a premium. We think a thematic approach can help to uncover lesser known and more attractively valued "hidden gems." Investors should recognize that themes such as the digital transformation of the economy transcend regions and also may support growth deep into value chains. Having analysts with specific regional and technical knowledge can help unlock this significant opportunity.

What we've seen: As part of the recent rotation toward value this year, stocks within tech-driven thematic trends have tended to underperform. However, with less stark economic "base effects" and the gradual reduction of accommodative monetary and fiscal policies, we anticipate that the economy could slow in 2022 and enter a period of more stagnant expansion. In that environment, we believe that looking to select avenues of secular thematic growth, such as the 5G transition, automation, fintech and next-generation health care could be useful to supporting equity return expectations. That said, we believe that thematic investing is about employing research to find quality companies exposed to secular growth themes, particularly at a time when many growth stocks are trading at relatively high valuations.

10 UNCERTAINTY PAVES THE WAY FOR OPPORTUNISTIC, IDIOSYNCRATIC STRATEGIES

What we said: Next year is likely to present an unusual mix of economic dynamics, with hints of cyclical acceleration against a backdrop of longer-term economy maturity, and ongoing pandemic and policy uncertainty. We believe any resulting volatility should provide a role for opportunistic strategies (for capital appreciation) and idiosyncratic, uncorrelated strategies (to lend stability to portfolios). Meanwhile, private investing opportunities will likely be found in sectors and regions where businesses have resilient growth prospects and executable business plans that add value amid uncertainty.

What we've seen: Recent market trends including Treasury and dollar volatility, and equity style rotation have created a rich environment for trading strategies and other liquid alternatives this year, with many of the benchmark HFRI hedge fund indices in strongly positive territory through the end of June. Private equity deals have continued to focus on companies with fundamentally strong businesses to ride out ongoing volatility, as well as the ability to generate strategic and operationally driven growth. In our opinion, recent market volatility has served as a reminder of the need to seek out new sources of diversification as the world emerges from the pandemic.

Asset Matters

Private Equity in Focus

We believe private equity constitutes an appealing addition to traditional assets, with an array of options for access and diversification.

INVESTMENT STRATEGY GROUP

Private equity has for many years been an area of broad investment interest, given its attractive risk/return profile and low correlation to other asset classes. However, the practical issue of access has often been a constraint. Strict investor qualification requirements, large investment minimums, long lock-up periods and cash-flow/return patterns have generally limited private equity access to institutions and wealthy individuals who are better positioned to deal with these hurdles. Recently, however, an array of innovations has helped open up the asset class to more investors, enhancing opportunities for diversification and reducing practical constraints to exposure.

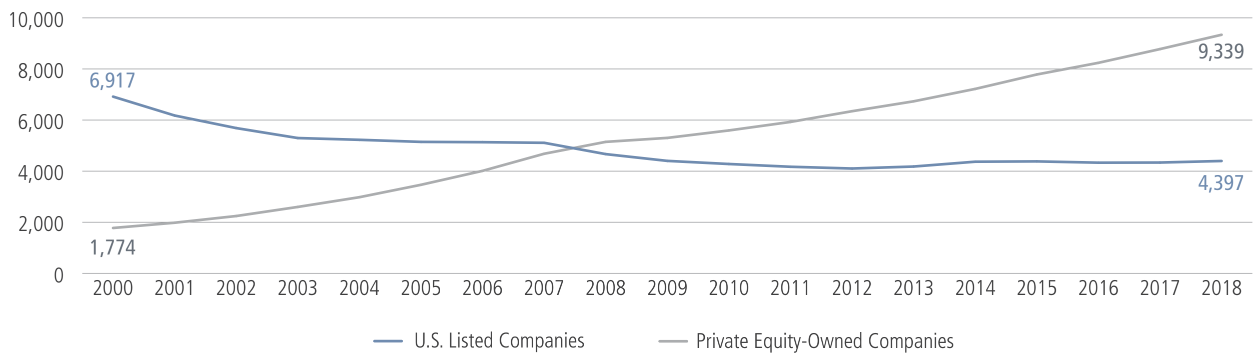
In this article, we explore the case for private equity, look at its unique characteristics, discuss key sectors and vehicles, and provide insight on how investors can introduce the asset class into their portfolios.

PRIVATE VS. PUBLIC MARKETS

At its most basic level, an investment in private equity means an investment in a company that does not trade on a public exchange. Although this might seem a superficial distinction, it can bring with it dramatically different fundamental characteristics, while opening up a whole new universe of investment opportunities. Keep in mind that the number of U.S. public companies has declined over time, in large part due to expense and regulatory constraints, while the number of private companies has increased in light of their flexibility, control benefits, less shareholder scrutiny and often lower costs. Although still a small fraction of the public market in terms of capitalization, the number of private companies now far exceeds that of their public counterparts.

SHIFT TOWARD PRIVATE FUNDING

Number of U.S. Public vs. Private Equity-Owned Companies



Source: PitchBook and World Bank. Data as of December 2018, the most current available data from the World Bank.

STRUCTURAL OPPORTUNITIES

When considering private markets, it's important to understand the various characteristics that allow private equity managers to seek to add value that may not be available within public markets. Here are a few:

Information and Control: Private markets are relatively inefficient, which means that managers can often generate informational advantages. They typically enjoy more direct and transparent governance control, and, thus, have the potential to create value through strategic and operational improvements. Unlike public companies, they generally are not subject to quarterly reporting and can capitalize on long-term time horizons in seeking to generate value.

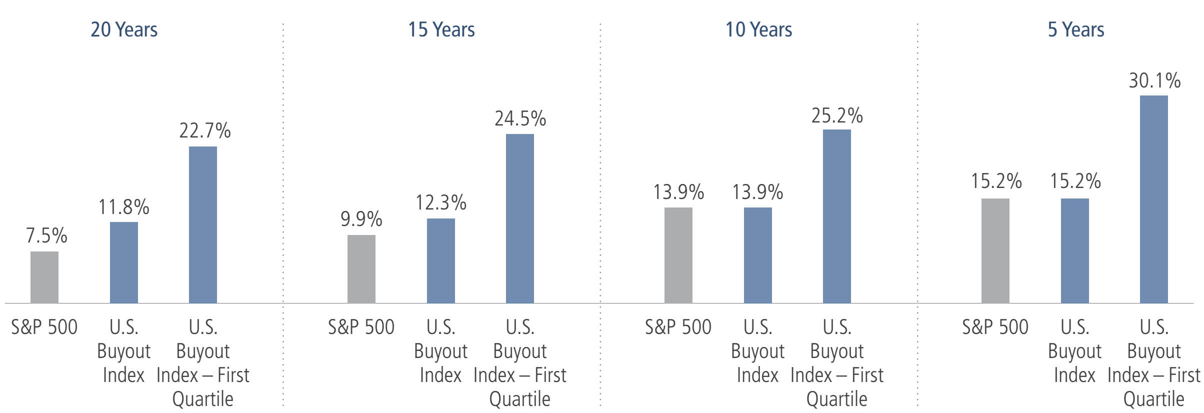
Timing: Private equity managers often spend months sourcing and completing investments, and have various exit opportunities, including trade sales, sales to other private equity funds and initial public offerings (IPOs). The flexibility around the timing of both their entry into and exit from positions may provide for advantages over most public market managers.

Distinct Opportunities: Private companies are often very different from the larger firms that can cope with and thrive on the demands of public ownership. It is far more difficult for a company that is in a changing industry or early in its growth cycle to do well in the public markets, where investors increasingly demand consistent, linear growth in earnings. Often private companies just don't have a publicly investable equivalent. In a public setting, they might be hidden from view as very small divisions of larger companies; as private holdings, their value may be apparent more readily.

In our view, this combination of advantages has been intrinsic to the attractive return history of the asset class. As shown below, private equity (as represented by the buyouts sector) has outperformed traditional equities over multiple timeframes. Of particular relevance is the strength of top-quartile managers, given the wide dispersion of results in the asset class (see box on page 16).

LONG-TERM PERFORMANCE RESULTS

Annualized Returns vs. Traditional Equities: Buyouts



Source: Cambridge Associates. Represents pooled horizon IRR and first quartile return for the U.S. Buyout Index from Cambridge Associates as of December 31, 2020, which is the latest data available. Nothing herein constitutes a prediction of future economic or market environment. Due to a variety of factors, actual events or market behavior may differ significantly from any views expressed. Indices are unmanaged and not available for direct investment. Investing entails risks, including possible loss of principal. **Past performance is not indicative of future results.**

KEY SECTORS

Given the growth of the private marketplace, we see it as no surprise that a broad variety of companies across industries are available for investment.

Buyouts are perhaps the most well-known segment of the private equity universe, where a manager will purchase control of a company with the goal of generating value by professionalizing the business, improving the management of cash flows, and introducing strategic changes. These may involve acquisitions based on geography or product area, or divestment of noncore businesses. Buyouts typically involve more mature businesses, and investors often expect them to deliver steady returns, supported by a combination of financial and operational improvements.

Venture capital businesses are typically much newer, often with rapidly growing revenues combined with negative cash flows. They usually require regular infusions of capital to expand into new markets or reach new customers. Often, they are still owned by the founders or a small group of "angel" investors, so that venture capitalists come in as minority owners. Given their higher risk, venture funds are likely to include 30 – 40 companies, compared to 10 – 15 for a buyout fund. Typically, just a few large "winners" are expected to more than offset the losers in order to drive overall attractive return potential.

Of the other key sectors, **growth** companies usually fall somewhere between buyouts and venture in terms of business age and size, with managers working alongside the founders to expand more rapidly, while **special situations** involve the restructuring of distressed companies.

Finally, **private credit** involves privately negotiated loans to companies. This area expanded with the post-financial crisis pullback by banks from private lending, and issuances are commonly seen as part of private equity deals. Companies appreciate the flexibility of private credit, while investors typically receive a higher yield than for similar publicly traded debt in exchange for a degree of illiquidity. Interest payments are typically immediate; therefore, returns are often generated earlier than with private equity investments.

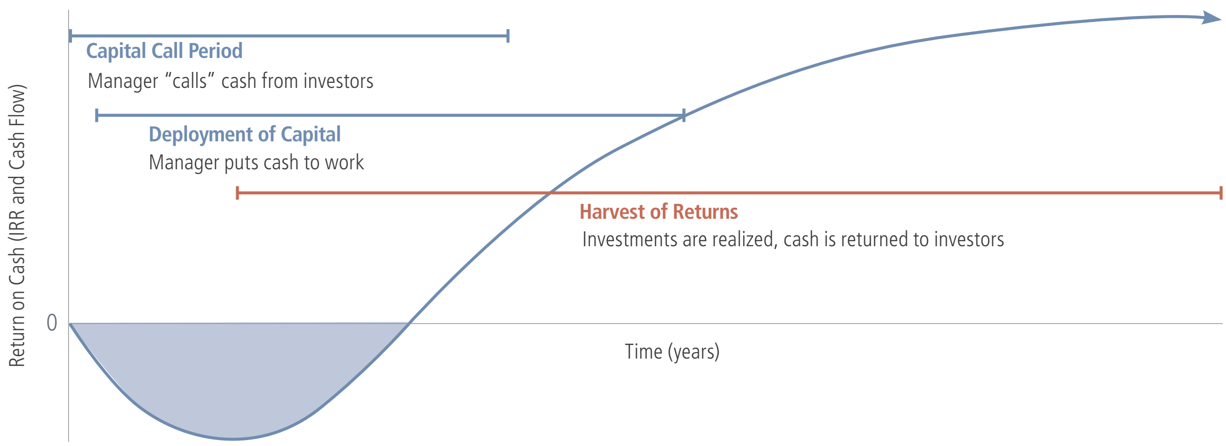
MEANS OF ACCESS

How can investors gain access to such opportunities?

Primary funds, often considered the core vehicle for private equity exposure, place money directly into portfolio companies. Such funds have a life span of around 10 years, with a pattern of cash flows known as the J Curve. The investor makes an initial capital commitment, which the manager draws on for four or five years, after which investments are harvested and, along with any proceeds, are returned to the investor over a multiyear period. For diversification, investors often choose a **fund-of-fund** structure, which may provide exposure to more companies through multiple primary fund investments.

PRIVATE EQUITY MANAGERS TYPICALLY ENJOY MORE DIRECT AND TRANSPARENT GOVERNANCE CONTROL, AND, THUS, HAVE THE POTENTIAL TO CREATE VALUE THROUGH STRATEGIC AND OPERATIONAL IMPROVEMENTS.

THE 'J CURVE': CAPITAL CALL, INVESTMENT AND REALIZATION PERIODS
Internal Rate of Return of a Private Equity Fund



For illustrative purposes only.

Co-investment is an increasingly common way to access private equity, where investors invest in portfolio companies alongside a private equity manager or "lead sponsor." In such cases, the manager may not have the capacity to fund an entire deal or may prefer to limit its exposure. The arrangement reduces so-called "blind-pool" risk associated with traditional private equity funds because the investor already knows which company is involved and can conduct specific due diligence. Co-investments typically avoid the fees associated with a primary fund, because the investments are direct. Further, such investments allow the immediate use of capital rather than following the J Curve pattern discussed above. Although concentration and commitment size tend to limit single co-investments to large institutions, the approach is often used in dedicated co-investment funds or within funds of funds and other structures that may incorporate a co-investment allocation.

Secondaries are another important strategy for private equity investors that can help with some of the potential drawbacks of primary funds. Investors may seek to sell their holdings in the secondary marketplace for a variety of reasons—including to lock in returns, proactively manage exposures or access liquidity. Over the past couple of decades, the secondary market has gradually expanded and matured to become a standard means through which some investors can make these sales and others can gain access to already seasoned private equity investments, often at a small discount.

Secondaries can provide diversification by vintage year, manager and underlying portfolio company, as well as offer capital efficiency from earlier distributions, making them particularly attractive to investors looking to ramp up their private equity holdings. They also can reduce "blind pool" risk.

Historically, individuals have faced hurdles in accessing private equity due to investor qualification rules and high minimums, as well as long-term illiquidity and the J Curve. However, **new structural innovations** have begun to mitigate these issues. For example, while traditional private funds typically require a net worth of $5 million, certain registered funds have reduced this figure to $2.1 million, while investment minimums have also been reduced, sometimes to as low as $50,000.

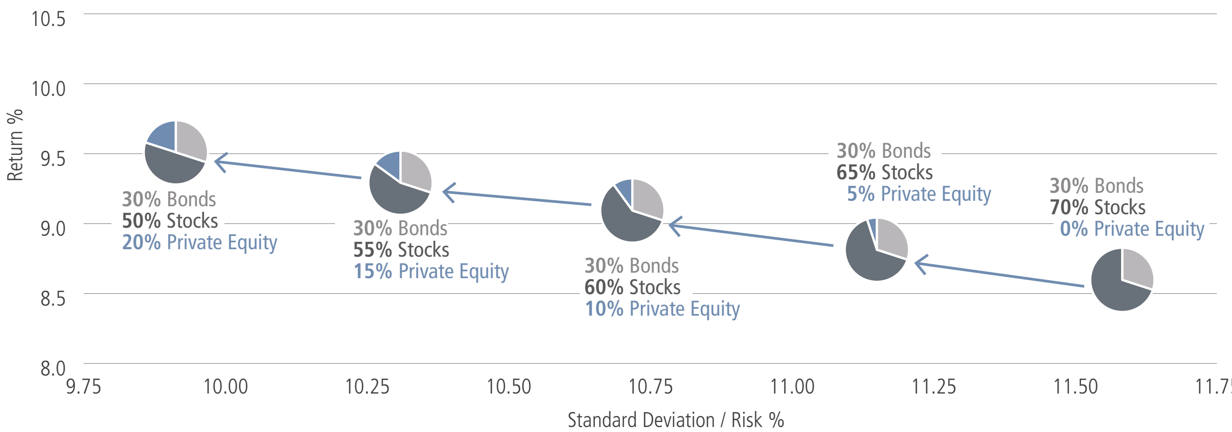
The newer structures can also use the array of strategies above to help with illiquidity and mitigate the J Curve. For example, while primary funds will typically constitute the foundation of a portfolio, the combined use of secondaries and co-investments, along with private credit, can help to both put money to work more quickly and generate income and return on capital in a shorter timeframe than many traditional funds.

INTEGRATING PRIVATE ASSETS INTO PORTFOLIOS

Historically, private market investments have not only enhanced potential return, but also diversified and reduced overall portfolio risk (see display at the top of page 15). That's particularly relevant in light of the strong performance of traditional asset classes in recent years and, by extension, their reduced return outlooks for the future given high equity valuations and low interest rates. Although private equity has also benefited from price appreciation, it still provides a discount to its public counterparts, while managers tend to have a unique ability to generate value due to structural opportunities we've discussed.

PRIVATE EQUITY'S RISK/RETURN PROFILE

Past 25 Years



Source: Neuberger Berman, FactSet. The Barclays U.S. Aggregate Index represents bonds the S&P 500 Index represents equities, and the Cambridge Associates Global Private Equity Index represents private equity. The chart shows 25 years of data ending December 31, 2020. Nothing herein constitutes a prediction of future economic or market environment. Due to a variety of factors, actual events or market behavior may differ significantly from any views expressed. Indices are unmanaged and not available for direct investment. **Past performance is not indicative of future results.**

Although individual circumstances vary, we typically favor introducing roughly 7% exposure to the asset class for a moderate investment profile, with the target increasing alongside investor risk tolerance. Still, much depends on the specific portfolio. For example, an investor with a particular desire for income may choose to emphasize private debt and/or other income-oriented private market strategies. Those with more balanced needs could combine income and return-potential-enhancing strategies, while more aggressive investors could lean toward return-focused areas. Note that we fit private markets into a broader "alternatives" bucket where commodities and hedged strategies (designed to reduce market exposure) could also play a role. Below, you can see how we lay out these hypothetical choices at a very high level.

HOW CAN PRIVATE EQUITY FIT INTO A DIVERSIFIED PORTFOLIO?

Hypothetical Allocations Based on Investor Profile

Risk Tolerance	Conservative		Moderately Conservative		Moderate		Moderately Aggressive		Aggressive	
Investment Objective	Income		Balanced Income		Balanced		Balanced Growth		Growth	
Corresponding Stock/ Bond Portfolio	0% / 100%		25% / 75%		50% / 50%		75% / 25%		100% / 0%	
	Target	Range	Target	Range	Target	Range	Target	Range	Target	Range
Fixed Income	**100%**	**85 – 100%**	**75%**	**60 – 90%**	**50%**	**35 – 65%**	**25%**	**10 – 40%**	**0%**	**0 – 15%**
Equity	**0%**	**0 – 15%**	**25%**	**10 – 40%**	**43%**	**28 – 58%**	**55%**	**40 – 70%**	**75%**	**60 – 90%**
Alternatives	**0%**	**0 – 15%**	**0%**	**0 – 15%**	**7%**	**0 – 22%**	**20%**	**5 – 35%**	**25%**	**10 – 40%**
Commodities	0%	0 – 5%	0%	0 – 5%	0%	0 – 5%	3%	0 – 6%	3%	0 – 6%
Hedged Strategies	0%	0 – 5%	0%	0 – 5%	0%	0 – 5%	3%	0 – 6%	4%	0 – 8%
Private Markets	**0%**	**0 – 5%**	**0%**	**0 – 5%**	**7%**	**0 – 14%**	**14%**	**0 – 28%**	**18%**	**0 – 33%**

Source: Neuberger Berman. For hypothetical and illustrative purposes only. Does not describe the terms or characteristics of an existing product. This material is general in nature and is not directed to any category of investors and should not be regarded as individualized, a recommendation, investment advice or a suggestion to engage in or refrain from any investment-related course of action. Investing entails risks, including possible loss of principal.

We believe diversification is crucial in private equity, and is typically accomplished across asset class, vintage year, strategy, geography and manager. From a practical standpoint, the size of an available portfolio (and the regulatory qualification of a given investor) may dictate the degree to which they can access certain strategies and vehicle types. At the lower range, investors may accomplish private equity exposure through the registered funds discussed above, whereas the higher the asset level, the greater the potential variation of available product, including custom accounts.

Investment time horizon is also an important factor to consider. Depending on the circumstances, those in mid-late career or early in retirement may have more freedom to set aside assets for longer periods, while the same may be said for those interested in growing assets across generations. Some registered private market funds may be designed to offer enhanced liquidity, and can also be an option for those who need access to assets sooner. That said, we have found that investors tend to be conservative and overestimate their need for liquidity—something that a cash-flow analysis can help clarify.

In our view, investors should understand the cash-flow issues associated with private equity. For a majority of private market strategies, there may be a lag between an initial commitment and manager capital calls, and a long timeframe for return of capital and realization of profits. When investing through such structures, we believe investors can typically assume that about 60% to 70% of their committed capital will be invested at any given time, so they may wish to over-allocate in order to hit a given portfolio allocation target, for example committing $1.2 million to $1.5 million to generate $1 million in exposure.

In addition, we note that traditional private equity investments carry with them a certain degree of administrative complexity that isn't usually present with public market investments. This is evident not only in their cash flow requirements, but also in the tax reporting that is often involved, including K-1 tax forms. In contrast, more liquid alternatives may have simpler tax reporting.

All told, we believe that investors that desire a more accessible approach to private markets may wish to consider a registered fund, although the tradeoff may be a reduced return profile. For those willing and able to accept a greater degree of complexity, consistent subscriptions to traditional vehicles (usually limited partnerships) can help with the pursuit of potentially higher returns (see table on page 17).

CONSIDERING PRIVATE EQUITY

As we have discussed, private markets offer an array of opportunities that may not be available in the public space. The advantages of information and control, timing of entry and exit, and a long-term time horizon have contributed to the asset class' attractive return profile, while its distinct investment characteristics have enhanced its value as a diversifier. In addition, the availability of funds of funds, co-investments, secondaries and private debt has helped with the cash flow challenges of the J Curve, while the introduction of registered fund options has greatly simplified and opened up access to the asset class. That said, the choice of adding private markets exposure will likely come down to the specific circumstances of the individual, including risk tolerance, time horizon, liquidity needs, asset levels and comfort with the segment's unique characteristics. Engaging with advisors is an important first step in assessing whether private equity may make sense as part of your diversified portfolio.

MANAGER SELECTION IS KEY

We believe choosing a quality portfolio manager is valuable regardless of investment type, but it is especially crucial in private equity, where performance dispersion can be significant. According to Cambridge Associates, over the 10 years through December 31, 2020, the average private equity manager returned 13.9% but the average top-quartile manager returned over 10% more, compared to a much narrower gap for managers in public markets. Experience, deal access and performance history are all key characteristics to consider. Given the long-term nature of the asset class, having a team that has worked together for an extended period, and has deep understanding of the private markets and company specifics can make a major difference. Also important is a demonstrated willingness to maintain and expand resources to adapt to a changing landscape. Assuming exposure to private equity makes sense for a given investor, having a quality manager in place can enhance their potential to capitalize on opportunities (and mitigate the risks) in the asset class.

UNPACKING PRIVATE MARKET VEHICLE CHOICES

Choosing the appropriate vehicle for private market exposure involves an array of individual considerations, but may boil down to (1) target allocation size and (2) comfort with complexity and the unique characteristics of the asset class.

Registered Funds

Access to multiple segments and managers provides diversification within a single SEC-registered vehicle. Fund structure offers simplified tax reporting, and relatively low investment minimums and qualification requirements.

Subcategories

'Evergreen' Fund	'Drawdown' Fund
Single fund without capital calls and potentially improved liquidity, but often with lower return potential vs. a standard "drawdown" structure. No defined fund life; will consistently allocate to investments over time.	Typical private equity structure, including capital calls and distributions with a defined life (typically 10 years).

Traditional Structures/Limited Partnerships

A range of available approaches, with differing levels of diversification and customization. Depending on the strategy, often include a capital-call period prior to potential distributions (the "J Curve"), and often require long-term investment commitments. Vehicles typically have high minimums and qualification levels, and involve more complex K-1 tax filings.

Subcategories

Commingled/ Diversified Fund (e.g., funds of funds)	Individual Funds	Custom Account
Diversification across managers and sectors through a single investment. Regular commitment to ongoing fund vintages typically required to achieve vintage diversification. Traditional cash flow patterns, with some funds providing additional flexibility. The investor may have minimal control over the portfolio.	Private equity exposure through a commitment to multiple individual funds. Often in specific areas such as buyouts, venture, growth, secondaries, co-invest and private debt. Provides extensive investor control, but requires high levels of capital, research and resources.	Hybrid of commingled and individual funds. Affords professional manager involvement in an overall private equity portfolio, with a degree of investor control.

For illustrative purposes only. This material is general in nature and is not directed to any category of investors and should not be regarded as individualized, a recommendation, investment advice or a suggestion to engage in or refrain from any investment-related course of action.

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

ESG Investing

Looking for Sustainability in Munis

The municipal bond market can provide significant opportunities for ESG and impact investors.

JAMES A. LYMAN, *Director of Municipal Research*

Investment informed by environmental, social and governance (ESG) factors has become commonplace on the equities and corporate fixed income landscape. However, it's less well understood that ESG and so-called impact investing can be successfully applied to municipal bonds. Indeed, what we consider effective markers tied to sustainability are ample, and can provide a rich universe of insights—and important warning signs—for those willing to explore the sector with a research focus.

Broadly speaking, ESG analysis addresses a set of performance risks that arise from factors that have often been overlooked by investors. The concepts are outlined in the U.N.-sponsored Principles for Responsible Investment, which leading portfolio managers including Neuberger Berman have signed, pledging to incorporate ESG into their research and investment processes. ESG-informed managers will consider sustainability along with other more traditional elements in assessing the risk/reward of a given security.

Impact, or sustainable, investing takes things a step further. It means that you not only consider the risk factors associated with ESG, but place particular emphasis on them in your investment process. This can mean exclusion based on screening (e.g., avoiding tobacco, firearms or nuclear power) or, in a more nuanced framework, gauging the overall ESG record of an issuer in relation to effects on its performance and the investor's social goals. Even then, an impact investor may choose to exclude certain issuers that, regardless of securities pricing, simply don't meet the investor's standards.

COMBINING ESG AND TRADITIONAL CREDIT RESEARCH

Over time, we have found that ESG concepts and traditional credit research have considerable overlap. When conducting municipal research, managers and analysts typically look at five factors: governance, financial condition, leverage, the legal structure of a bond, and the condition of the economy. Of these, governance and financial condition are typically the most visible in the context of sustainability.

- The "G" in ESG, governance is a critical and, in our view, often predictive, part of credit analysis: Are elected officials and their appointees implementing efficient and apolitical policies and programs, and are budgets structurally balanced?
- Environmental risk (the E) can relate to financial condition. For example, a town that is cited repeatedly for releasing excess raw sewage may be hit with fines and have to issue new bonds to cover the cost of improving the system—increasing its leverage and thus hurting its credit profile.
- Social factors (the S) may fall under economic risks/opportunities, and can have implications for financial results. For example, an ESG framework can help reveal whether zoning, economic development or tax-abatement policies could negatively (or positively) affect the income mix of a given community.

ESG analysis formalizes and reinforces such qualitative assessments, while often requiring portfolio managers to look past optics for deeper understanding.

MINIMIZING ESG RISKS

How do you identify issuers or securities with potentially negative ESG-related impacts that could boomerang on municipal investors? At a basic level, this involves understanding the nature of the various pockets of the municipal bond market and being rigorous in determining the materiality of a given risk.

In the municipal market's early days, financings were very simple and mostly used for the typical infrastructure needs of state and local governments. Over time, however, the boundaries of law and regulation were stretched, and the municipal market became a source of funding, not only for traditional infrastructure, but also for projects that inordinately benefitted private players or didn't even serve a public purpose.

Going Nowhere

You may have heard of the "bridge to nowhere," which became a symbol of pork-barrel spending in the 2008 presidential election. Although Alaska's Gravida Island Bridge was federally funded, such money-wasting projects exist at the municipal level as well. Other examples have included economic development bonds for convention centers, and loans or grants to commercial entities for economic development.

Often, such transactions become a drag on governmental credit quality due to the additional leverage. And—of particular importance for impact investors—the public is generally not the real beneficiary of proceeds; rather, that's the private business receiving a low cost of capital via tax-free bond issuance. In some cases, the municipality guarantees these transactions, thus creating a contingent liability that could potentially hurt taxpayers. In others, nongovernmental uses of proceeds can have a social benefit, for example when an investor-owned electric company issues pollution-control bonds to comply with environmental laws.

Bad Sports

Professional sports stadiums may also have a negative impact. Towns and cities are often pressured to help finance new stadiums to avoid the departure of a sports franchise. But at the end of the day, the benefits of the new stadium typically accrue to franchise owners (in the form of more revenues), rather than the community. Developers of Yankee Stadium, for example, built a parking garage on nearby parkland. As it turns out, the bonds issued to build the structure have since become distressed due to underuse. In short, some transactions appear to benefit society, but upon deeper review reveal a misuse of public funds or just poor public policy.

Politics Unusual

From an issuer perspective, it is sometimes mismanagement or the political process that causes collateral damage.

We have historically been wary of issuance from Illinois, where we've observed a tendency for political considerations to supersede the public interest; for example, budget stalemates in 2015 – 17 led to deep underfunding of public education, which could have been avoided through compromise on other line items. California offers a more reassuring picture: Although the state has had its own political issues, we believe it has managed the budget process effectively in recent years, providing extensive services while spending within its means.

For investors who are cognizant of ESG-related factors, such issues will typically be balanced against price. The bonds of a particular municipality or project may provide a generous yield that compensates for the additional risk from a given negative practice. On the other hand, some issues may be poorly understood by markets; ESG-informed investors may be more cautious, and thus likely able to avoid "yield traps." As mentioned, impact investors may choose to avoid certain issuances altogether.

ON THE RISE: CLIMATE AND SOCIAL RISKS

Although governance has long been a focus of municipal investors, with increased concern over global warming, environmental risk is becoming more prominent. Rising sea levels and more extreme weather patterns are contributing to coastal flooding, while intense droughts have added to the country's wildfires, most prominently in California. Such acute physical risks are by nature unpredictable, and we believe municipal analysts must seek to account for them in modeling securities prices. Along these lines, our firm has invested in data systems to calculate weather-related risks and their economic impact. Also relevant are gradual weather effects. For example, one southern community saw its water table fall due to a lack of rainfall, requiring that it import water, adding costs for the town and its homeowners. On a more macro level, frequent droughts can cut into agricultural production, resulting in lower tax revenues in already strained communities.

Social factors are also having more effect on municipalities, and to a degree that many investors may not understand. The social risk we focus on most is income inequality, an issue that has been highlighted during the pandemic (see sidebar). Lower income groups often face more significant health challenges, with potentially significant impacts on local finances. Moreover, if a larger portion of the next generation has less disposable income, their ability to buy housing will likely be compromised. That could affect the real estate market, which in turn could undermine the tax base of bond issuers. Although often beneficial, community development projects can sometimes worsen disparities: Higher rents associated with larger employers may drive out smaller businesses and lower-income workers, which can reduce the appeal of a town or city, and by extension weaken its fiscal outlook.

A UNIFIED PROCESS

Despite the common misconception that ESG can be "bolted on" to an investment process, we believe that consideration of environmental, social and governance issues should be integral to the efforts of analysts in the municipal space. Moreover, the risks and opportunities represented by ESG factors are just too significant to leave to primitive screens or quantitative-based rating systems that lack human intervention. The municipal bond universe has more than 55,000 issuers with a wide range of credit fundamentals. In our view, extensive research, a disciplined process and a consistent philosophy, all informed by ESG considerations, should be key advantages in seeking to balance risk and return potential in the sector over time.

COVID-19 AND INCOME INEQUALITY

The global pandemic has laid bare the issue of income inequality and the challenges faced by underserved communities, particularly when it comes to health. Lower income areas tend to have populations with pre-existing conditions and weaker public health safeguards. During the recent crisis, these vulnerabilities translated not only into undue suffering, but also sizable costs and budgetary pressures. The rapid development and distribution of vaccines, as well as federal economic stimulus, helped to fend off even more serious consequences; however, the potential for more setbacks—whether in the current crisis or in the future—suggests the need for proactive and creative steps to improve public health across income levels. We believe this requires some degree of federal response, but it will also be a function of local leadership. Issuers that are able to make progress in this area may not only serve their communities, but set the table for more stable credit fundamentals over the long term.

OUR 'THREE PILLARS OF IMPACT'

Impact investing goes beyond considering ESG factors in portfolio management to making them a driving force—both to avoid bad actors and to achieve positive effects on the world at large. When investing for impact, we see three elements as important, both individually and in combination, in determining the potential merits of a given bond or issuer:

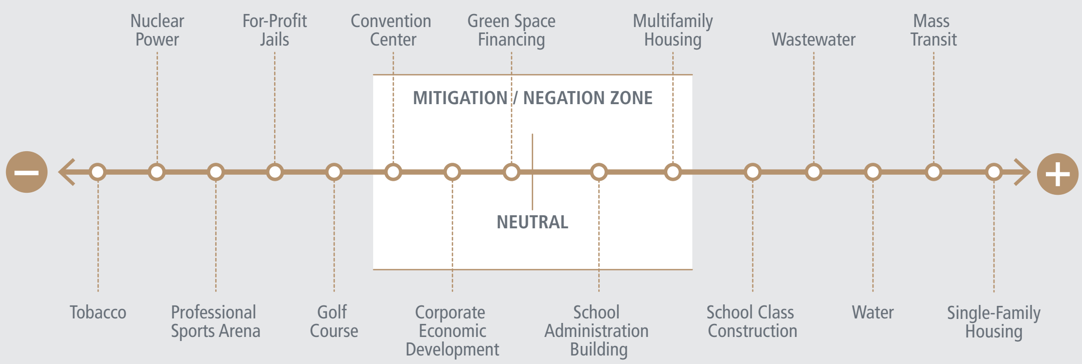
1. ISSUER GOVERNANCE: Is the issuer well managed with respect to governance, fiscal sustainability and management of material social and environmental issues?

Examples: Puerto Rico's fiscal picture was unsustainable for more than a decade; investing at the time would have reinforced practices that ultimately contributed to bankruptcy. In contrast, Pennsylvania has suffered from late budgets, but its political process has become more constructive, for example, allowing for stop-gap funding to support essential programs while seeking to solve broader fiscal issues.

2. USE OF PROCEEDS: Will bond proceeds from a project generate effects on the community and environment that could be essential, significant and positive overall?

Examples: Professional and sports arenas tend to benefit private entities, not the public. Innovative classroom programs for the underprivileged and moderate-income housing construction often have a positive impact on the community.

Impact Spectrum: Use of Proceeds



Source: Neuberger Berman.

3. COMMUNITY NEEDS: Does the location of the project have a higher level of relative need, and thus greater potential to contribute to solutions to social or environmental challenges?

Examples: Wastewater treatment that benefits lower-income communities, and mass transit that opens up economic opportunity, fit into this category. Most issuances tend to benefit either the general populace or more affluent communities, making place considerations relatively challenging to address.

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

Trust Company Corner

Gifting and More…While You Wait

As tax proposals circulate through Washington, DC, it may make sense to consider current estate planning opportunities before rules change.

ELIZABETH M. SOMMER, *Chief Fiduciary Officer, Head of Personal Trust, New York, Neuberger Berman Trust Company*

The Biden administration's American Families Plan, announced in April, is ambitious not only in terms of spending but also in its proposed changes to the tax code. Some features include raising ordinary income and capital gains tax rates for wealthier Americans and eliminating (above certain thresholds) the step-up (and step-down) of basis at death. However, a much-feared reduction in the current federal estate and gift tax exemption (currently $11.7 million per individual) has been excluded for now, leaving it to sunset after 2025 to its 2017 level of $5.49 million plus inflation adjustments. The plan also leaves in place annual gifting rules, which currently allow each individual donor to make tax-free transfers of up to $15,000 to as many individuals as desired without dipping into his or her exemption. Even so, much remains in flux. Various other legislative proposals *do include* curbs on the exemption and certain gifting vehicles, such as trusts, as well as raise the estate tax above its current maximum 40% rate (see the table on page 27).

In the current uncertain environment, we stand by the dual principles of (1) making thoughtful, timely planning decisions and (2) where appropriate, capitalizing on the tools currently available to transfer assets. Among these tools, we believe gifting remains highly useful, often working in tandem with other strategies. In this article, we discuss several techniques that remain viable today but may be curtailed later.[1] As such, they could be worth undertaking as we wait for clarity through the legislative process.

ANNUAL EXCLUSION GIFTS

Under current law, every person can give away up to $15,000 per year to as many individuals as he or she wants without using any federal gift and estate tax exemption. The $15,000 is indexed for inflation, which allows for potential increases in future years. Spouses can each give $15,000 to the same person, or one can be deemed to gift on behalf of both spouses, for a maximum per couple of $30,000. For those with large families, this approach can enable the transfer of substantial amounts over multiple years.

EDUCATIONAL AND MEDICAL EXPENSES

Significant transfer tax savings can also be achieved by taking advantage of the ability to make certain payments for educational and medical expenses without incurring gift tax. Under current law, any amount paid on behalf of any individual as tuition to an educational

[1] The bulk of the Biden tax proposals would be effective on January 1, 2022, although his capital gains tax increase would be retroactive to April 2021. A number of Senate proposals, including new limitations on certain trusts, would be effective upon "enactment," which appears to mean when signed into law. Although retroactive changes to the tax law are unusual, they are not unprecedented, making it important for readers to weigh the pros and cons of planning techniques with their attorneys in light of the current legislative landscape.

organization, or to any provider of that individual's medical care, is not treated as a gift. For these payments to qualify under this exception, they must be made directly to the educational institution or medical provider. Reimbursements to the individual for these expenses don't qualify.

ESTATE AND GIFT TAX EXEMPTION TRANSFERS

The current exemption from estate, gift and generation-skipping transfer tax is $11.7 million per individual. Assuming one is comfortable making significant gifts, using the federal exemption to make lifetime transfers generally is more advantageous than waiting to apply it at death:[2] Once transferred, the growth of those assets is outside of the donor's estate, enhancing the value for the recipients. Note that it is typically more effective to give away cash or property with a basis equal to current market value, rather than low-basis assets like long-term stock holdings, because the donor's cost basis is carried over to the donee. This approach avoids transferring assets with a built-in income tax liability and/or losing out on the step-up at death.[3] If the latter is largely eliminated, as proposed by pending legislation, we believe these issues would be less of a concern.

GIFTS TO GRANTOR TRUSTS

Rather than make direct gifts, it may be advantageous to transfer assets to lifetime trusts for children, grandchildren and others, which allow for professional oversight by a trustee and can offer protection against creditors. If structured as a grantor trust, the creator (grantor) of the trust is considered the owner of the trust for income tax, but not estate tax purposes. Accordingly, the grantor pays all the income taxes generated by the trust property (essentially a tax-free gift), permitting the assets in the trust to grow free of current income taxes. As a completed gift, however, the trust assets will not typically receive a step-up in basis at the grantor's death because they would not be included in the grantor's estate. That said, the trust can be drafted to allow substitution of other assets, typically with a high basis, to bring the low-basis assets back into the estate, where they can benefit from a step-up.

Note that under a proposal from Senator Bernie Sanders, grantor trusts created post-enactment would be includable in an individual's estate, and transactions in and out of the trust would be subject to taxation. So, if desired, creating a grantor trust soon may be worth considering, including when used with other strategies, including loans and sales (see discussion on page 26).

SPOUSAL LIFETIME ACCESS TRUSTS

A Spousal Lifetime Access Trust (SLAT) allows couples to retain access to assets while capitalizing on the gift tax exemption. The grantor typically creates an irrevocable trust for the ultimate benefit of his or her descendants that permits the other spouse (or significant other) to draw on the assets at the discretion of the trustee, if needed. Additionally, as a grantor trust, the SLAT places the income tax burden of any trust earnings on the grantor. If structured properly, the trust removes the assets from the estates of both spouses and can potentially capitalize on the generation-skipping tax exemption to benefit heirs over

IN THE CURRENTLY UNCERTAIN ENVIRONMENT, WE STAND BY THE DUAL PRINCIPLES OF (1) MAKING THOUGHTFUL, TIMELY PLANNING DECISIONS AND (2) WHERE APPROPRIATE, CAPITALIZING ON THE TOOLS CURRENTLY AVAILABLE TO TRANSFER ASSETS.

[2] Even if the full exemption has been used up in lifetime gifting, making additional taxable gifts may be preferable to waiting until death because any associated current tax liability is not included in the gift. Looking at a hypothetical example, at a 40% rate, a $1,000,000 lifetime gift may incur $400,000 in federal taxes, for a required asset total of $1,400,000. However, if the same amount is bequeathed at death, the decedent is taxed on both the intended gift and the taxes that would have been removed from the estate—at a 40% rate, roughly $667,000, or $267,000 more would have otherwise been needed to make the same transfer as a lifetime gift.

[3] Typically, it is also preferable to avoid gifting an asset with a built-in loss, given that the recipient will not receive the tax benefit of the loss when the asset is sold.

time without additional transfer taxes. Keep in mind, however, that in the event of divorce, the grantor's indirect access to the assets may be cut off, as would occur with the death of the beneficiary spouse.[4]

LOANS/SALES TO TRUSTS

Although not a technique to leverage use of the exemption, loans by a grantor to his/her grantor trust can be another effective tool to generate wealth for heirs, particularly given current low interest rates. It may be appropriate for those who have fully used their exemption or are more comfortable giving away growth and not their principal. The grantor makes a loan to the trust and applies the applicable federal interest rate (AFR) published monthly by the IRS to avoid the loan being deemed a gift. The trust invests the loan proceeds to benefit from any appreciation beyond the interest rate charged by the grantor. The AFR is currently very low; in July, for example, the interest rate for a loan of three years or less is just 0.12%. The growth of the loaned amount in excess of the interest rate is not considered a gift and is effectively removed from the grantor's estate. Unlike a direct loan to an individual, the grantor does not recognize income from the interest payments because the transaction is viewed by the IRS as if he is loaning money to himself. It is possible to structure loans with interest-only payments for the life of the loan and a balloon payment at the end, which can help maximize potential investment growth. Note that the loan will need to be repaid, and that any default may be treated as a taxable gift. Loans to grantor trusts can also be structured as sales, where the same rules largely apply.

Certainly, loans or sales can be made directly to individuals without the use of a trust, in which case the interest payments back to the lender are includible in his/her personal income tax return.

GRANTOR RETAINED ANNUITY TRUSTS

Like loans and sales, a Grantor Retained Annuity Trust (GRAT) is a technique that can transfer wealth for those who have used up their exemption or only want to pass on appreciation. A GRAT is an irrevocable trust to which the grantor transfers property and retains an annuity stream for the term of the trust, with the remainder passing to heirs (or trusts for their benefit). Typically, the annuity is equal to the value of the property when originally transferred, plus interest, computed using the AFR in effect at the time of the funding of the trust (the rate is somewhat higher than for the loan noted above). Accordingly, upon creation of the trust, when any gift is determined, there is deemed to be no remainder to pass to the heirs—hence, no gift. However, if the assets in the trust increase in excess of the IRS interest-rate, there will be a trust remainder that will pass to heirs gift-tax-free at the end of the trust term. Usually, the terms of GRATs are short—two or three years—because if the grantor passes away during the term, some portion or all of the GRAT will be includible in the grantor's estate.

GRATs are particularly compelling when the IRS interest rate is low, as remains the case today. However, under another proposal by Senator Sanders, GRATs would be subject to a 10-year minimum term and the projected remainder interest would need to be 25% of the value of the trust at creation, or $500,000, whichever is greater—an amount that would be subject to gift tax. Creating the trust prior to the enactment date of such legislation, if approved, could be essential.

FLEXIBILITY TO RECHARACTERIZE, UNWIND TRANSFERS

Given the degree of uncertainty, we believe planning arrangements should be as flexible as possible in their treatment of gifts, trusts and other elements, so they can be unwound or recharacterized if tax laws change in unexpected ways. For example, an individual could fund a new trust this year for the benefit of his spouse with terms that would enable the trust to qualify for the marital deduction. The election to qualify the trust is made on the donor spouse's individual gift tax return that is filed next April (or October 2022 with an extension). If, after the funding of the trust, the exemption is reduced retroactively, causing the transfer to be subject to gift tax, the donor spouse can choose to make the transfer a marital gift to avoid the tax. Although the terms of the trust may not be exactly what the couple would have wanted if it was being drafted as a non-marital trust, this approach can help achieve an appropriate outcome regardless of legislative changes.

DON'T WAIT

When it comes to estate planning, a common rule of thumb is to take advantage of favorable tax treatment when available—because you never know when the policy tide will turn. Given recent trends, it seems likely that some form of additional taxation or change in tax rules could have an impact on current approaches—whether it happens in the ongoing legislative cycle or down the road because of budgetary pressures. One cause of hesitation in making current gifts has been the worry that if taxpayers fully use the current exemption and die after it has been decreased (whether due to a new law or the scheduled post-2025 sunset noted above), there could be an estate tax "clawback" on the amount used above the new level. Fortunately, the IRS has issued favorable rulings that appear to alleviate these concerns. Overall, we believe the advantages of lifetime gifts (assuming the money is available) versus testamentary transfers militates toward current action.

More broadly, decisions about wealth transfer take into consideration an array of issues beyond the tax regime, including the assets available for transfer, and choices regarding individual and personal legacy. As mentioned, it may also be important to draft estate documents flexibly, to keep options open. Talking with your advisors is a key first step in assessing whether making gifts, creating and funding trusts or employing other techniques could be effective or appropriate for your circumstances.

[4] Some attorneys believe that the beneficiary spouse can be provided with a limited power of appointment at death to transfer the trust assets within a group of beneficiaries, which possibly could include the grantor spouse, enabling continuing access for the grantor should the beneficiary spouse predecease him/her. Be sure to consult with your own counsel before proceeding.

PERSONAL TAX PROPOSALS: HIGHLIGHTS

The President and various legislators have proposed significant changes to the current tax regime affecting individuals and their planning. Below are some key provisions, which come from the Biden administration unless otherwise indicated.*

Area of Impact	Current	Proposed Change
Ordinary Income Tax	Top marginal rate of 37%**	Top marginal rate of 39.6% for those with income over $400,000
Deductions	High standard deduction, no personal exemptions, limitations on itemized deductions**	Cap itemized deductions at 28% of value. Restore Pease limitation on itemized deductions for taxable income over $400,000
Net Investment Tax	3.8% tax on passive income from passthrough entities	Broader application to those earning over $400,000, likely including active owners of passthrough entities
Carried Interest	Taxed at long-term capital gains rates	Taxed at ordinary rates. The 3.8% Medicare surtax would apply
Qualified Dividend/ Capital Gains Tax	Top rate of 20%	Top rate of 39.6% for those with income over $1 million; retroactive to April 2021
Step-Up of Basis, Recognition of Gains	Step-up in tax basis at death; gifts not taxable below exemption amount, donee receives basis of donor	Eliminate step-up, tax unrealized capital gains at death above first $1 million, or at time of gifting
Estate/Gift/GST Tax Exemption	$11.7 million exemption**	Biden: No change. Sanders***: Estate tax exemption reduced to $3.5 million, gift tax to $1 million; GST (generation-skipping transfer tax) exemption eliminated. Trusts subject to GST every 50 years
Estate/ Gift Tax Rate	40% top rate	Biden: Unchanged. Sanders: Increase to 45% – 65% graduated rates
Annual Gift Tax Exclusion	$15,000 per recipient, per donor each year	Biden: No change. Sanders: Limit gifts to qualified trusts to $30,000 per donor
Like-Kind Exchange	Real estate like-kind exchanges may be entitled to capital gains tax deferral	Eliminate like-kind exchanges for taxpayers with income over $400,000
Trusts, Valuation Discounts	Flexibility on terms, use of exemptions, allows for effective wealth transfer	Biden: No change. Sanders: Grantor trusts (non-grandfathered) included in grantor's estate; distributions to beneficiaries and conversions to non-grantor trusts would be taxable gifts. Curbs on discounts, GRATs

Source: The Tax Foundation, news reports. As of June 30, 2021.
*Certain Biden campaign proposals did not make it into the President's most recent tax package. These include a payroll tax on wages above $400,000 (in addition to the current tax on up to $142,800 in wages), and a cap on itemized deductions at 28% of income. Although Biden did not ultimately propose a change to the estate tax, legislation from Senator Bernie Sanders and others covers these areas.
**Set to expire after 2025 under the Tax Cuts and Jobs Act of 2017.
***All "Sanders" items are set forth in the Vermont senator's "For the 99.5 Percent" Act. A different group of senators has sponsored the Sensible Taxation and Equity Promotion (STEP) Act, which contains overlapping and, in some cases, more stringent provisions.

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

Philanthropy

Digging Into Board Service

The "what, who, when, where, why and how" of deepening your charitable commitment.

MARIA ANGELOV — *President, Neuberger Berman Foundation*

"Giving back" to organizations or causes you care about can take many forms. Some individuals choose to volunteer regularly, perhaps attending meal shifts at a local food pantry or mentoring a high school student. Others may volunteer on an ad hoc basis, for example, through their company's annual volunteerism program or with their families around the holidays. Still others may choose to support nonprofits financially, either through annual gifts to selected nonprofits or by supporting family and friends' fundraising efforts, such as in 5K races.

Beyond these meaningful contributions, I believe one of the most personally rewarding and impactful ways to serve is as a nonprofit board member. Indeed, for those who have not already done so, I would encourage exploration of board membership—which may be the ultimate gift of service to an organization, combining donations of time, expertise, passion and money.

Below are my "what, who, when, where, why and how" of board service, both in terms of getting involved and maximizing your effectiveness.

I BELIEVE ONE OF THE MOST PERSONALLY REWARDING AND IMPACTFUL WAYS TO SERVE IS AS A NONPROFIT BOARD MEMBER.

WHAT ARE THE ROLES OF A BOARD MEMBER?

While each board and junior board will have its own set of responsibilities and expectations, there are several general guidelines for all board members. The most straightforward roles of a board member are to provide time and money. In this case, time means attending board meetings (find out the cadence for your nonprofit—some may be quarterly, others more frequent) and fundraising events (usually one major annual event or gala and perhaps something smaller). Donating and fundraising are key components of serving on a board. The term "give/get" may come up when discussing the financial expectations of an organization. Board members are usually expected to commit to a certain dollar amount. "Give/get" implies that a board member can either make outright donations of the expected amount or achieve it through fundraising; however, it is important to be clear as to what your board's expectation is, as some organizations ask for both—a flat donation and fundraising.

Nonprofit boards are generally not responsible for managing the day-to-day operations of an organization's programs, but rather act as a governing body. This group of individuals is responsible for ensuring that the organization is adhering to its mission and maintaining its integrity. The board can develop the organization's mission, set strategy, evaluate the nonprofit's leadership (including the CEO or executive director), and should protect the organization financially and legally.

Along these lines, a nonprofit board member acts as a fiduciary, which entails a duty of care, loyalty and "obedience." The duty of care requires that the board member be familiar with the organization's finances and operations, and actively participate through board meetings, votes and reviews. Loyalty means acting solely in the best interest of the nonprofit, rather than in their own interest. (Organizations typically have a written conflict-of-interest policy and require board members to disclose any potential conflicts.) Finally, in observing their duty of obedience, board members must ensure that the organization is faithful to its mission and obeys applicable laws and regulations.

WHO IS BOARD SERVICE RIGHT FOR?

Serving on a board (even a junior board) may sound intimidating, and while a level of commitment is necessary, it can also be a great opportunity for those ready to take the next step.

Have you been volunteering with or donating to an organization regularly for several years? Is there a cause or nonprofit that you've attended galas for, introduced your friends to, or that addresses issues that you are passionate about? Whenever I am approached at work about potential organizations that may be looking for board members, I first ask the inquiring person what they care about. It may sound trivial, but I believe it's important to go with what "pulls at your heartstrings." If you are able to articulate an organization's mission, find yourself knowing the names of the organization's staff members and even clientele, and feel moved and fulfilled in attending fundraising events, then board service may be right for you.

Your expertise may also make you a strong candidate for board service. Perhaps you have a CPA and can lend a hand reviewing an organization's balance sheet, or you have a passion for event planning and can help plan a fundraising dinner. Or maybe you have a knack for HTML design and think the organization could use a website makeover. Nonprofits need a wide array of skills and perspectives to make things go smoothly.

Finally, perhaps you have conducted direct service volunteering (reading to children, serving meals, spending time with seniors, etc.) and you are ready to take things further, and learn more specifically how the organization functions. There is no single correct path to board service, but having the experience and/or expertise that we've described can help clarify your thinking and make you feel more comfortable stepping into this commitment.

WHEN IS A GOOD TIME IN MY LIFE FOR BOARD SERVICE?

Board service is special in that it can be right for someone at any stage of life. For young professionals, it may be a good way to dip their toes into leadership and responsibility. For those in the middle of their career, it can help tap into passions outside of work and family. And for those late in their career or in retirement, it's a vehicle to share skill and life experience.

That said, committing to serving on a board also means committing your time, and it's important to understand the organization's expectations. Most senior boards meet at least quarterly or every other month and expect board members to attend one or two events per year. Other organizations may be newer and need board members to roll up their sleeves and be more involved in development. A common understanding of the time and financial obligations involved can be crucial to both you and the nonprofit.

WHERE CAN I FIND AN ORGANIZATION?

Often, individuals have an organization in mind when considering board service. Others may cast a wider net to identify the right match. In that case, even though there are thousands of nonprofits operating nationally, I would suggest searching locally. This allows you to meet with the organization's leadership and board, consider volunteering if you have not done so already, and ensure that you will be able to attend meetings and events more easily. Local service also allows you to be more connected to the community in which you live or work. Certain organizations that specialize in board placement can help refine your search (see Resources on page 31).

WHY BOARD SERVICE?

In addition to providing service and expertise to an organization, there are many reasons why board service can be beneficial to participants. First and arguably foremost, it can be deeply rewarding. Nonprofit organizations work with limited budgets and resources; having people who are deeply supportive and can commit time, expertise and money is invaluable to them. For the board member, attending fundraising events and participating in service projects can become more meaningful when you are part of the leadership team.

Serving on a board also allows you to leverage your specific skills. Most boards ask their members to join subcommittees for fundraising, membership, investment and other matters. By serving on a board, you have the opportunity to share your day-job professional skills with an organization that may not have a paid staff member who focuses on that area. It can also give you the opportunity to explore skills that you may not get to use during your day job, such as planning an event. More broadly, board service provides a direct way to work on leadership, communication, teamwork, problem-solving and resource-development skills.

Board service is also a great way to broaden your professional network. The peers on your board may be in your industry, allowing for networking opportunities. Or perhaps your fellow board members are in entirely different professions, allowing for new contacts. Chances are, if you are serving on a board together, you will likely find similar interests outside of the organization that you care about.

HOW CAN I BE AN EFFECTIVE BOARD MEMBER?

Committing to service on a nonprofit board means committing to the nonprofit itself. While you are not responsible for administering the programs, you are responsible for supporting the nonprofit's mission and doing so, hopefully, with conviction and passion. An unspoken or unwritten responsibility of a nonprofit is to share the organization with your network for two reasons: 1) to raise awareness of the organization's work and 2) to identify future donors. Time is a limited resource and if you are committing to an organization, it should be one that you are excited to talk about. In my view, being an effective board member also means being honest with yourself and being comfortable with this commitment.

GETTING STARTED

The choice of board serve depends on your personal priorities and availability. I believe it's important to be thoughtful in your choices, and to conduct extensive due diligence on the organization you wish to serve and its effectiveness in achieving its stated goals. Taking preliminary steps such as talking with board members and participating in volunteer activities may also make sense. Moreover, it's a good idea to review financials to gauge the health of the organization. Such efforts can also provide insights into whether you would be comfortable working with the nonprofit and whether your particular skills could help to fulfill its mission. In the end, I believe the effort can be well worth it—to ensure that you have a positive experience and that you can make a real impact where you believe it is needed most.

RESOURCES

Board Service

National Council of Nonprofits: A resource and advocate for nonprofit organizations. Its "Tools and Resources" page details various issues of interest, including boards and governance. (councilofnonprofits.org)

Boardsource: Helps nonprofit boards set strategic priorities and structure governance. See the "Topics" page for information on board roles and responsibilities. (boardsource.org)

Board Search

BoardnetUSA: Digital service that matches board candidates with nonprofits. (boardnetUSA.org)

Points of Light: Online community connects nonprofits, businesses and individuals in seeking to address societal issues. (pointsoflight.org)

United Way: Mobilizes the "caring power of communities to advance the common good"; clearinghouse for service opportunities. (unitedway.org)

VolunteerMatch: Database of volunteer opportunities, searchable by location. (volunteermatch.org)

Highlights 3Q 2021

FROM THE ASSET ALLOCATION COMMITTEE

We believe strong economic growth is likely to continue over the next 12 months, with uncertainty around inflation and Federal Reserve policy potentially contributing to heightened market volatility.

Equities: U.S. small caps, as well as non-U.S. developed and emerging markets offer relative opportunity given their exposure to the global economic recovery. We hold a neutral 12-month view of U.S. large caps, leaning toward value and cyclicals, with defensive and growth stocks providing balance to portfolios.

Fixed Income: With low yields and a likely upward bias in interest rates, investment grade bonds generally offer limited return potential. We continue to favor non-investment grade fixed income, and particularly floating-rate loans, while emerging market debt valuations have improved in recent months.

Commodities: Commodities could provide exposure to a surge in pent-up demand as the economy improves, although some segments appear fully valued. Gold and other precious metals could serve as a safe haven during near-term uncertainty.

Private Equity and Real Estate: While private equity valuations appear elevated, a focus on operational improvements to businesses may create value away from potential public market volatility. Private real estate is enjoying tailwinds from economic reopening and inflationary pressures.

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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For more information on COVID-19, please refer to the Centers for Disease Control and Prevention at cdc.gov.

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