AVENUE

PROST!

VALERIE STEELE ON THE COLOR THAT WON'T FADE (HINT: IT'S NOT BLACK)

L'CHAIM!

WILLIAM D. COHAN TOASTS THE GREAT RECESSION'S 10TH ANNIVERSARY

SALUT!

KELLY LAFFEY RAISES A GLASS WITH GABBY KARAN AND GIANPAOLO DE FELICE

ON THE BEACH

FINANCIAL ROUNDTABLE

Dollars and Sense

MARKET ADVISORY FROM OUR PANEL OF EXPERTS

moderated by Kelly Laffey

photographed by Michael Ostuni/Grassi

AVENUE: Can you talk about how families should plan for students leaving for college?

HENRY: The impending departure for college is an opportune time for open dialogue between parents and their children. At Northern Trust, we created a checklist for clients of what we think are several essential discussions—from healthcare, the implications of financial independence, insurance, even absentee voting. One of the most important is deciding whether a son or daughter will sign a healthcare proxy, which allows their parents to be informed if they are somehow incapacitated. It may also be useful to execute a power of attorney, which allows parents to take on certain legal responsibilities, like signing a lease while the student is away at school. Finally, there is the question of whether it may make sense to consider a will (and or a living will). All of these conversations are imbued with the weight of what it means to be an adult and, in our experience, help in the transition to what for many young people is their first real step toward independence.

JOEL: For a lot of the high-net-worth clients, they actually get a big price break when the kids go to college, especially if they've been paying for private school in the city and they've saved their money through the 529 plan. Kids go to college around the same time when a mortgage might be getting paid off, so it's a nice catalyst for the parents to also look at it from their own standpoint, particularly so they can ensure that this decade gets them to where they want to be as far as retirement.

AVENUE: On June 13, the Federal Reserve raised interest rates, and signaled there will be two more increases by the end of the year. They said the economy has improved enough for borrowing costs to increase without stunting economic growth. Was this a good move? Why or why not?

MARK: The market expectations are the Federal Funds rate will probably be close to 2.25 percent by year end, and perhaps 3 percent as we head into the end of 2019. It reflects the realities of our growth prospects today. Clearly, the economy has good momentum. The jobs numbers have never been better. GDP projections are moving higher. I think the normalization of rates is more reflecting this reality. The Fed has moved from a $1 trillion balance sheet pre-2007 to $4 trillion today. They need to normalize those rates, and therefore they will continue to liquidate their portfolio holdings because they need ballast in the event that we experience another potential downturn in the future.

TONY: I agree. I think that one of the reasons why the Fed is able to move as aggressively as it has is because the economy is experiencing a fair amount of fiscal stimulus that wasn't necessarily expected a year or two ago, in the form of both the tax packages as well as the current budget deficit. So all of that is creating a lot of tailwind for the economy. The Fed can step out now as being the accommodator of first resort, and allow Congress to play a role here.

ALLAN: I'm concerned about the Fed raising rates. For one, I think they're playing catchup. We've had a really strong economy for a number of years now, and they are now rushing and raising rates at a faster pace than before. Right now, we have a situation where you've got fiscal policy stepping on the gas through the $1.5 trillion tax cut, and you've got the Fed stepping on the brakes. These things are creating volatility. They're creating some pain to come. You see a flattening of the yield curve, which, every time it goes inverted, tends to lead to really bad things. The pace of rising rates puts pressure across the economy, both on consumers and then also on companies.

"Higher expected returns are primarily coming from growth assets, so diversification is crucial"
—Mark Lieberman

AVENUE: What are your views on inflation and the impact on asset allocation of the clients?

HENRY: Our investment process is driven by the clients' goals and asset sufficiency—what they own, what they will own and what they owe and will owe. As such, thinking about the inflation rate is essential to thinking about assets and income in the future. We do all of our planning for clients on a "triple net" basis—meaning looking at results net of fees, taxes and inflation. This helps clients to visualize the choices that they are making and how they are invested in the context of what they actually have and will have. Inflationary pressures are real, and seeing their impact, regardless of level, is hugely valuable for clients.

Participants

ALLAN BOOMER, Managing Partner and Founder of Momentum Advisors

JOEL ISAACSON, President of Joel Isaacson Company.

HENRY P. JOHNSON, President, East Region, Northern Trust Wealth Management

MARK LIEBERMAN, Managing Director at First Principles Capital Management, a subsidiary of American International Group, Inc. (AIG)

TONY ROTH, Investment Officer of Wilmington Trust and MT Bank

KELLY LAFFEY, moderator

ALLAN: I don't think inflation generally is an issue, except in certain pockets. First is labor and wage inflation. It's politically popular to raise the minimum wage, but there are a lot of businesses that are being squeezed by this, versus having more of a market mechanism on wages rising. The second is oil prices. Because of what's going on politically, you're starting to see oil prices go up. That impacts the pump, which is like a tax. Higher interest rates, and higher wages, will then lead to higher prices for service items. Coupled with the price at the pump going up, too, that really will start to crimp the consumer ultimately.

MARK: It is important to understand the potential impact of inflation and interest rates on investment portfolios. It is more important for investors to monitor inflation-adjusted real yields rather than nominal yields. Higher real yields are very destructive for growth assets and capital formation. Real yields can increase in one of two ways: One, the Fed aggressively raises interest rates faster than inflation expectations, and overshoots their inflation target.

Mark Lieberman

The second way is if we experience significant deflationary expectations, where inflation falls faster than interest rates. That's the reason why, until recently, the Fed has been very aggressive at lowering rates, because they don't want to get into the conundrum of having a deflationary spiral, which effectively increases real yields. So with regard to how inflation may impact portfolios, I think watching the real yield, which is the interest rate tied to inflation, is critical in knowing what may happen to growth assets in client portfolios.

TONY: Allan makes a great point around the risks around wage inflation. One of the things that we're very focused on from an economic standpoint is whether or not the economy can accomplish a more meaningful increase in its productivity than it has had over this investment cycle. If we get a big increase in productivity, that will help to abate the pressure on wages, as companies look to grow their output. One of the things that gives us optimism is that there was a long period where, despite the fact that companies had pretty attractive corporate profits, they were very reluctant to reinvest those profits in their businesses. They instead used those profits to buy back stock and decrease p/e ratios in order to push the price up. The tax cuts seem to have provided an extra level of cash flow to companies beyond their growth in earnings. They seem to have been willing to reinvest in infrastructure. We have some hope that we're going to start to see some real meaningful improvements in productivity.

AVENUE: What is the role of fixed income in client portfolios?

MARK: Traditional fixed income plays an important role for the investor, and one needs to understand the objectives of the client. Higher expected returns are primarily coming from growth assets, so diversification is critical. We like to think about fixed income from either a diversification, income or liquidity perspective. It makes little sense to look at traditional fixed income from a total return perspective. Nontraditional fixed income is where one can generate higher expected risk adjusted returns.

ALLAN: I love fixed income. Fixed income is the anchor to the wind in times of volatility and distress. You look at the 2008 financial crisis. The one asset that did not lose value at the worst point in the storm was high-quality fixed income. It was Treasury bonds. People talk about the fact that rates are rising and bonds are going down. You have to think about it in perspective. This year bonds are down about 2 percent, and it's the worst bond market we've had in about two decades. Go back 20 years in equities and see what the worst period was like, and you're seeing down 40 percent or 50 percent. I love to put fixed income in retirement accounts. When you get clients who get to that age of 70½ and they have to start taking those distributions, that's the point when you don't want your retirement account to be large. If you put growth assets in a retirement account, you're making your tax bill a lot bigger.

"The differences from one state to the next can be extremely compelling, but you have to understand the nuances."
—Henry Johnson

Joel Isaacson

Allan Boomer

JOEL: I disagree. I look at those retirement accounts as, they give you 26 years to pay them out, and then, if you leave them to your next generation, they could spread the money over their life. I'd hate to say to anyone that I am trying to keep an asset class that really was deferred income as low as possible. I'm more growth-oriented.

TONY: Let's hope that when these clients retire and take distributions, there's still a capital gains preference. Because the way we're going in this country with deficit, and the debt that we're accumulating, it's almost inevitable that we're going to have an alignment in Washington of a more liberal administration that's not going to have such a preferential view to capital formation. So that gap could certainly change a lot.

AVENUE: Can you talk about how clients can use their investments to express personal values in socially responsible investing?

HENRY: First, you have to understand the difference between socially responsible investing (SRI) and mission driven investing. It is increasingly a focus among certain clients to look beyond an investment's underlying promise to better understand it—what they do, how they do it, how they are run, their approaches, etc. to assure that those align with the client's own views and values. Some clients are looking for you to exclude opportunities that do not align—to screen them out—whereas others are willing to give up return if they feel an investment will achieve a different, often nonfinancial return goal. Fluency around these issues and opportunities is something we see more and more clients coming to the table with a real clarity on.

JOEL: It's a tough thing to monitor for, especially if you're packaging products in the ETF market or the mutual fund market. A lot of it has big tax consequences, especially if you've been in the market for a long time. Then there's the issue of, does socially responsible investing have as big an impact as opposed to the direct impact of investing for the highest returns, and then giving more money directly to a charity that's fighting for a socially responsible cause? It's a combination.

MARK: If you look from a pure investment perspective, investing in ESG is…it's potentially restrictive, because you are limiting the efficient frontier of investing in assets. So I think the comment about giving up some return in order to hold investments you feel you're aligned with is the right way to look at it. So our view would be to avoid that type of investing from a pure investment perspective. Having said that, we know about the George Costanza Theory, which is basically do the opposite. I think the more assets that come into ESG investments, prices will go higher. From this technical perspective, we think particular ESG offerings will perform well.


Henry P. Johnson


Tony Roth

"The tax cuts seem to have provided an extra level of cash flow to companies beyond their growth in earnings."
—Tony Roth

TONY: I agree with what everyone said. But we're not seeing it translate into a tidal wave of commitment yet. Because there is this question: Is doing good tantamount to doing well as an investor? And what is that gap? What we've found is that if you think of SRI as an exclusionary approach to investing, "I don't want these kinds of things," that's fine: you can do that without having a material impact to your investing. ESG is affirmatively looking for certain things, and restricting yourself. We think that does hurt your investor returns. But then the tail on all this, which we found to be incredibly intriguing of late, is in that private market space where there are sponsors that are involved in the impact space. One can look, for example, at renewables. There's a phenomenal set of investment opportunities for renewables that fit squarely within ESG. So in that area in particular, in the impact area in the private market space, there are definitely interesting opportunities where you put a little bit more effort in, and you can find ways for clients that can tolerate the illiquidity to do just as well as sort of the more traditional run-of-the-mill private equity investments.

AVENUE: What has been the impact of the tax bill on clients, and specifically people in New York? And have many considered an out-of-state move?

HENRY: People often ask me about Florida because Northern Trust is the largest trust company in the state––we have 20 offices there and a long history of working with families from across the U.S. who are trying to understand what a change in state residency might mean for them. The differences from one state to the next can be extremely compelling, but you have to understand the nuances and challenges, too. In the tristate area, many of our clients are trying to get a better handle on the costs and benefits of deciding whether a domiciliary change could meaningfully change their total tax profile—we spend a lot of time working with clients to determine whether it has the potential to.

TONY: Since the tax legislation, we're seeing an increase in the use of strategies to export the income from New York to other states. A few years ago, New York really tightened up the rules, so that if you have New York beneficiaries of the trust, it's near impossible. But if you are a New York person and you can conceive of a scenario where the assets will never be consumed by a New York person, then there are some things you can do to shelter the income from state taxes. Not your earned income, but your investment income. Those structures are really interesting.

JOEL: There's a reason Florida has no taxes. You have to live there. Sorry.

ALLAN: I live in New Jersey and I have three children. I told my parents it's the grandparent tax. You want to see your grandkids, then you live in New Jersey. If you want to pay less taxes, then you live elsewhere and you won't see them as much. I think it's caused a lot of complaining, and I think people are paying attention, but I haven't yet seen people physically do anything about it. ✦