Fall 2017

Private Wealth Management

InSight

As we head into the final months of 2017, the UMB Private Wealth Management team is reflecting on the past year and looking ahead into 2018. Each fall, I evaluate my plans to ensure they align with my goals and encourage my team to do the same. These next few months are the time to take those last steps to meet your objectives for the year—a final push. Being intentional about self-evaluation can ensure a successful year-end and help jump-start your journey into 2018.

The fall edition of *InSight* focuses on the importance of planning your legacy with detailed business succession and exit roadmaps. Fifty-nine percent of business owners are looking to exit their business in the next decade; however, less than half have a formal succession plan. For these business owners, it is time to start thinking about how to ensure a successful business exit. To help facilitate a successful business transition, UMB Private Wealth Management is excited to launch a new service line designed specifically for those nearing retirement, and those ready to sell or pass on their business. Our business exit planning team help clients establish goals and intentions for preserving their legacy throughout their business transition.

This season's *InSight* also takes a look at topics to help you reflect on and align your financial plans to your goals. Susan Teson, Senior Vice President and Legal Counsel, reviews eight important reasons to revisit your estate plan. KC Mathews, Executive Vice President and UMB Bank's Chief Investment Officer, explores the delicate balance of active and passive portfolio investment and how the two strategies can work together.

Use this autumn season to evaluate your goals and how they fit into your overall life plan. UMB Private Wealth Management will be here to assist you in every step you take.

Sincerely,

Dana Abraham
President, Personal Banking, UMB Bank

The Yin and Yang of Investing

In Chinese philosophy, yin and yang describe how seemingly opposite or contrary forces may actually be complementary, interconnected and interdependent in the natural world. When you look at portfolio management, passive (indexing) and active strategies are the yin and yang of investing.

However, most of the debate around passive versus active investing comes from those advocating for one approach over the other.

We, on the other hand, believe they are complementary and not mutually exclusive. Based on our research, neither an all-passive, nor all-active portfolio, is an optimized portfolio. Rather, optimal appears somewhere in the middle, hence our comparison to yin and yang.

The Case for Passive

1. Narrow-Based Market

   For many years, the S&P 500 performance has been driven by a small number of stocks. Portfolios that do not own a handful of these stellar performing stocks will under-perform. In years where the S&P 500's total return is between three and 11 percent, a few select stocks drive the market's return.

   The median number of stocks driving the market is 10. So far, this year is no different. The S&P 500 is up seven percent, and 12 stocks are dominating performance.

   When the market is narrow-based, including passive investments in a portfolio is clearly beneficial.

2. Fees

   Passive funds simply replicate an index like the S&P 500 or the Russell 2000 and have lower management fees than actively managed funds. Fees negatively impact a fund's performance, and over the years there has been downward pressure on management fees on both passive and active managers.

   Remember, though, fees should be part of the investment process, not drive the investment process. Is the least expensive automobile the right one for you and your family? Perhaps not.

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3. Efficient Markets

   There is an academic theory called the efficient market hypothesis (EMH) that suggests it is impossible to beat the market. If the market is efficient, share prices reflect all relevant information and trade at fair value; therefore, active managers can't outperform the market.

   I would counter that some markets are efficient and others are far from it. For example, from 2009 to 2016, 80 percent of domestic, large capitalization managers under performed the S&P 500, suggesting it is efficient. However, in the same period, 60 percent of domestic small capitalization managers beat the Russell 2000, suggesting it is inefficient.

   The jury is still out on EMH. However, it is clear that some markets and asset classes are more efficient than others, once again supporting the yin and yang case of using both active and passive investments in your portfolio.

The Case for Active

1. Valuation

   The narrow-based market argument suggested that, at times, a few stocks drive the market. This year is no different. The top 10 performing stocks year-to-date trade at 3.4 times sales. The S&P 500 trades at 2.5 times sales, and the bottom 490 stocks in the index trade at 1.9 times sales.

   However, we believe that over entire market cycles, valuation matters. Historically, sooner or later, overvalued stocks under perform and undervalued stocks outperform.

   Most active managers attempt to buy undervalued stocks. By doing this, they can control risk and perform well over a market cycle.

2. Quality

   If the index was dissected into high-quality stocks (rated A+ to B+) and low-quality stocks (rated below B), as defined by Standard and Poor's, it would show they perform differently at various times.

   Low-quality stocks outperform during the early stages of a cyclical bull market, while high-quality stocks perform best in a bear market. Of course the index owns both high- and low-quality names.

   When safety trumps valuation, high-quality names will protect the portfolio. Thirty-one percent of the companies in the Russell 2000 index lost money last year, while high-quality stocks have not experienced negative returns over any 10-year period since 1986. Typically, active managers search for quality investments.

3. Dividends

   Dividends play two important roles. First, they can be a material factor in total return. If stock prices appreciate five percent and there is a three percent dividend yield, the total return is eight percent. Importantly, 37.5 percent of the total return came from dividends.

   Second, as companies pay and increase dividends, it sends a message that management is confident that earnings will increase. Since 1972, stocks that increase or initiate their dividend have outperformed the market by 2.6 times. During this period, dividend growers and initiators returned 10 percent annually versus the S&P 500's 7.6 percent.

   Active managers can build portfolios that seek out stocks with attractive and growing dividends.

All Investing is Active

Portfolio management requires numerous decisions. Asset allocation is paramount—which asset classes should be in the portfolio, and what allocation? Even if passive securities are to be used, which index is appropriate?

For example, the 2016 return for three passive small capitalization exchange traded funds, each with their own underlying index, had an eight percent return variance:

- iShares Core S&P Small Cap, 26 percent return
- iShares Russell 2000, 21 percent return
- Vanguard Small Cap ETF, 18 percent return

Every component of portfolio management requires a well thought-out and researched decision. Thus, all investing is active.

The Yin and Yang

Passive and active management styles are not opposite or contrary; they are complementary. Given our research, we believe using both styles strategically in portfolio management creates an equilibrium and holistic strategy. ■

KC Mathews, CFA
EVP, Chief Investment Officer, UMB Bank

As executive vice president and chief investment officer, KC Mathews is responsible for the development, execution and oversight of UMB's investment strategy. Mathews has more than 20 years of diverse experience in the investment industry. He earned a bachelor's degree from the University of Minnesota and a master's degree in business administration from the University of Notre Dame. He also attended the ABA National Trust School at Northwestern University and is a Chartered Financial Analyst (CFA) and member of the CFA Institute.

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Planning for a Legacy: Business Succession and Exit

According to the U.S. Small Business Administration, more than 50 percent of small-business owners are over the age of 50. This means that half of the 28.8 million small business owners in the United States are nearing retirement age in the next 10-15 years. For these business owners, it's time to start thinking about and creating a transition plan for successful business succession.

A well-thought-out plan can help prepare businesses for a smooth transition to the next generation or other persons without the loss of revenue, cash flow or consumer confidence. Families faced with developing a business succession and exit plan may want to consider working with a wealth management professional to help preserve the legacy of the operation.

They can help facilitate a phased and thorough approach that includes an inventory of assets, identifying the vision or goals for the business, structuring the estate plan and acting to carry out the established plan.

Inventory and Assessment

The initial step to completing a succession plan is compiling an inventory of assets. Establish a net worth of the entire operation, including all assets the business owns as well as a list of key people. Key people include anyone who keeps the business running, including critical external partnerships.

Also, it is important to identify all potential beneficiaries who would be entitled to proceeds if the business were to be sold. This may seem daunting, but a comprehensive inventory of all assets and relevant documentation, like deeds, should be made. Additionally, it will be necessary to include a list of personal assets, like retirement accounts, which can have an impact on the liquidity of the overall assets and tax effects.

Identify Goals

Although sometimes difficult, an established plan to communicate the goals and vision of the business is critical. The entire family should be included in these conversations, even those who have no intention of running the business in the future. Answering crucial questions such as, "What is the future of this company in five, 10 or 15 years," is necessary.

It may help to call a meeting where everyone can voice his or her needs and expectations, and each can be addressed. Together, family and business goals are crafted with these needs in mind and the goals should then inform the plan's details. The succession strategy should include naming a successor or successors who lead operations, deciding which assets to liquidate and transferring value as either ownership shares or monetary settlements. Open communication and intentional dialogue must be treated as a crucial component of a successful transfer strategy.

Develop the Tools

Proper estate planning provides clear direction on how to control property and assets during the owner's life, and extends that control if the owner is disabled. After death, the succession plan guides fulfillment of the owner's vision for the business operations, and takes care of loved ones. It is important to consider all aspects of personal and business wealth encompassed in the estate plan, including retirement income, estate taxes, asset distribution, business funding and any potential fees or taxes related to ownership transfers. Not all assets are appropriate for inheritance.

Refresh and Update as Needed

It will be necessary to make sure that, even if the plan is years away from being executed, assets are titled properly. When assets are added or sold, or when beneficiaries or management change, remember to retitle the assets and consult with a wealth advisor. This can be the difference between leaving a gift and establishing a legacy. Wealth advisors can assist in explaining the estate plan structure and in facilitating the conversation about the strategy—particularly, why the plan is built the way it is.

For any business owner, inaction is an action that can hold undesired consequences. A phased and thoughtful succession and exit plan provides long-lasting protection of the assets they have built, which can continue to grow for future generations. ■

Dana Abraham
President, Personal Banking, UMB Bank

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Eight reasons to revisit your estate plan

With changing tax laws, regulations and life circumstances, estate plans can easily outdate themselves. As such, they should be viewed as fluid documents, rather than an unchanging plan.

While a thorough assessment of an estate plan is encouraged yearly, these eight items should be kept top of mind when considering if it's time for a refresh.

1. Have Tax Laws Changed?

In 2001, Congress passed sweeping tax legislation that began the process to dramatically shift the landscape of estate planning. Unfortunately, many people still have estate plans that were created before these changes were enacted. The result? Higher exemption amounts may unintentionally affect married couples relying on traditional marital-non-marital trusts.

2. Have Marital Laws Been Updated?

In 2013, a court case opened the door for federal recognition of same-sex marriage. In 2015, the recognition of same-sex marriage became mandatory across all 50 states offering new planning opportunities for these couples.

3. Is the Family Dynamic Different?

Much can happen over time in a person's life. Marriage, divorce, new kids, loved ones passing away or becoming responsible for an individual with special needs. Any change in circumstance is an ideal opportunity to revisit an estate plan—especially when a person needs to be removed from a plan because of either death or divorce.

4. Has There Been a Move?

Moving can impact tax rates, tax types, probate laws and potentially available trust laws. In addition, some states are Community Property states, while others are not. The expansion of decanting—amending an irrevocable trust by pouring it into a new trust document—has allowed for a revisitation on some of these issues, even in irrevocable trusts set up in years past.

5. Are Beneficiary Designations Balanced?

Beneficiary designations are typically used to make certain probate assets non-probate. They must be reviewed periodically to make sure they are in harmony with the overall estate plan. In addition, while state law may correct an estate plan in the event of divorce or marriage, it might not update, for example, an individual retirement account (IRAs) beneficiary designation.

6. Is the Financial Picture Current?

An individual's portfolio makeup is dynamic and changes over time. The addition of real estate or a business to a portfolio, for example, means making certain a trustee, durable power of attorney or a personal representative knows and is empowered to carry out wishes regarding succession or sale.

7. Have Charitable Intentions Changed?

Is there desire to add a charitable gift or a new cause to the plan? Have already noted charities changed identity or split up? Are charitable beneficiaries properly identified? Now is the time to make those designations to ensure wishes are fulfilled.

8. Has Due Diligence Been Done?

Review estate plans to make sure it meets current wishes, is properly funded, unique assets have been property titled, and any necessary changes have been made.

Reviewing an estate plan may seem like a daunting task, but it's one that is necessary to ensure the plan is used to its greatest potential. With the partnership of your trusted team of legal, tax and financial advisors, an updated estate plan is the best way to ensure wishes are clearly stated and carried out when needed.

Susan Teson
Senior Vice President, Senior Legal Counsel, Fiduciary Tax Manager for UMB Private Wealth Management.

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2017 Outlook by the Numbers

		2013 (year end)	2014 (year end)	2015 (year end)	2016 (year end)	Most Recent	2017E	Trend
ECONOMY	**Real GDP Growth SAAR** (Annual Average) The economy rebounded in Q2, growing at 3.00% due to stronger than estimated consumption growth. Consumption grew 3.30%, bouncing back from a weak Q1 reading of 1.90%. Export demand remains strong due to the pickup in the global economy. We expect 2.30% economic growth for 2017.	1.70%	2.60%	2.90%	1.50%	3.00%*	2.30%	
LABOR MARKET	**Unemployment Rate** (Annual Average) After a decline last month, the unemployment rate moved up to 4.40% in August. The slight increase came as many Americans re-entered the labor force. The labor force participation rate was unchanged at 62.90%. The number of marginally attached workers (U6) was also largely unchanged at 8.60%	7.40%	6.20%	5.30%	4.90%	4.40%**	4.40%	
	Payroll Employment (Annual Average) Job growth slowed in August, with the U.S. economy adding 156k new non-farm jobs versus 200k expected. Despite this manufacturers nationwide added workers at the fastest pace in over four years. August brought moderate wage growth, with average hourly earnings holding steady at 2.50% y/y.	193k	251k	229k	187k	156k**	165k	
HOUSING	**Housing Starts** (Annual Average) Home builders slowed the pace of single-family and multi-family homes in July as U.S. housing starts fell 4.80% to an annual rate of 1,155k units. The pullback likely comes from the rising cost of materials and a shortage of skilled labor and buildable lots.	925k	1,003k	1,111k	1,166k	1,155k***	1,250k	
	Building Permits (Annual Average) Building permits for future construction fell 4.10% in July to an annual rate of 1,223k. Job growth, continued rising demand, and low mortgage rates should keep the single-family sector moving forward in 2017. Multi-family home building may slow following the recent increase in rental vacancy rates.	987k	1,053k	1,178	1,172	1,223k***	1,250k	
	Housing Prices Y/Y (Annual Average) Single-family home prices surged 5.70% in June and they continue to outpace income growth. Tight supply continues to put upward pressure on home prices, creating affordability issues for many U.S. home buyers.	13.40%	4.30%	5.60%	5.30%	5.70%****	4.00%	
INFLATION	**PCE Index Y/Y** (Annual Average) The U.S. PCE price index rose 0.10% m/m for July following no change in June. The year-on-year increase was an unchanged 1.40%. We expect inflation to increase over the next few years as wage gains accelerate due to the tightening labor market.	1.30%	1.50%	0.30%	1.10%	1.40%***	1.70%	
	Core PCE Index Y/Y (Annual Average) The core PCE price index, excluding food and energy, edged up 0.10% in July after a similar gain in June. As a result, the year-on-year rate now stands at 1.40%. This was the smallest year-on-year increase since December 2015.	1.50%	1.60%	1.40%	1.70%	1.40%***	2.00%	
	Consumer Price Index (CPI) Y/Y (Annual Average) U.S. consumer prices rose less than expected in July, up just 0.10% m/m after an unchanged June. The year-on-year rate increased to 1.70% from 1.60% in June. The relatively low rate of inflation can be partially attributed to a pullback in energy prices.	1.50%	1.60%	0.10%	1.30%	1.70%***	1.90%	
	Core CPI Y/Y (Annual Average) Excluding the volatile food and energy categories, core consumer prices rose 0.10% in July after a similar gain in June. Over the past twelve months, core prices have risen a modest 11.70%. Prices for mobile phone plans and prescription drugs were partly responsible for July's low inflation reading.	1.80%	1.70%	1.80%	2.10%	1.70%***	2.40%	

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2017 Outlook by the Numbers

		2013 (year end)	2014 (year end)	2015 (year end)	2016 (year end)	Most Recent	2017E	Trend
CONSUMER	**Consumer Spending (PCE)** (Annual Average)	1.50%	2.90%	3.20%	2.70%	2.70%***	2.90%	
	U.S. consumer spending increased 0.20% m/m in July and 2.70% y/y. Spending on durable goods showed a strong 0.80% increase while non-durable goods saw a 0.30% increase. Consumer spending will likely remain supported given a solid labor market and a rising stock market.							
	Consumer Confidence (U of MI) (Annual Average)	79.2	84.1	92.9	91.8	96.8**	96.0	
	Consumer sentiment rose to 96.8 in August, up 3.60% from July, and up an impressive 7.80% from August 2016. Consumer fundamentals remain robust due to a healthy labor market and support our forecast of continued solid consumption growth.							
INTEREST RATES	**Projected Fed Funds**	0.25%	0.25%	0.50%	0.75%	1.25%**	1.50%	
	We believe the Fed will raise the Fed Funds rate one more time in 2017, reaching 1.50% by year end. Fed rate increases are a positive reflection of the improvement in economic conditions, but at the same time tighten financial conditions.							
	Projected 10-Year Treasury	3.00%	2.17%	2.30%	2.44%	2.12%**	2.75%	
	The 10 year Treasury yield will likely be driven by increasing inflation expectations from an improved fiscal policy outlook. We expect the 10 year Treasury yield to trend higher throughout the second half of 2017.							
EQUITIES	**S&P 500 Price**	1,848	2,059	2,044	2,239	2,472**	2,440	
	The market trades near all-time highs due to robust earnings and revenue growth. Any fiscal stimulus will boost corporate earnings. We believe total returns will be in the low-double digit range over the next 12 months.							
	S&P 500 Operating EPS Growth	6.80%	6.30%	-3.30%	0.00%	16.29%*****	15.00%	
	We believe earnings will grow by 15.0% y/y in 2017 as the drag from the energy sector wanes. There is meaningful upside to our earnings estimates if we get corporate tax reform, as the S&P 500 effective tax rate is around 28.0% compared to proposals of 15.0-20.0%.							
GLOBAL ECONOMY	**World GDP** (Annual Average)	3.30%	3.40%	3.10%	3.10%	3.00%*	3.40%	
	Global economic growth continues to be subdued at around 3.00% given secular challenges, such as a slowing labor force population, weak productivity, and high levels of debt. We feel political risk is waning, which is beneficial for economic growth.							
	Emerging Markets GDP (Annual Average)	5.00%	4.60%	4.40%	5.40%	5.10%*	4.40%	
	Emerging market growth has been pressured as commodity prices have been weak and China is attempting to stimulate its economy. We believe the recent rebound in commodity prices could help stabilize growth. China continues to be the economic growth engine in the emerging markets.							

*Quarter over Quarter Seasonally Adjusted Annualized Rate, as of Q2 2017
**As of August, 2017
***As of July, 2017
****As of June, 2017
*****Trailing 4 quarters
[1] E=Estimate

Positive
Neutral
Negative

Trending Down
Trending Up
Trending Down
Trending Up

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