

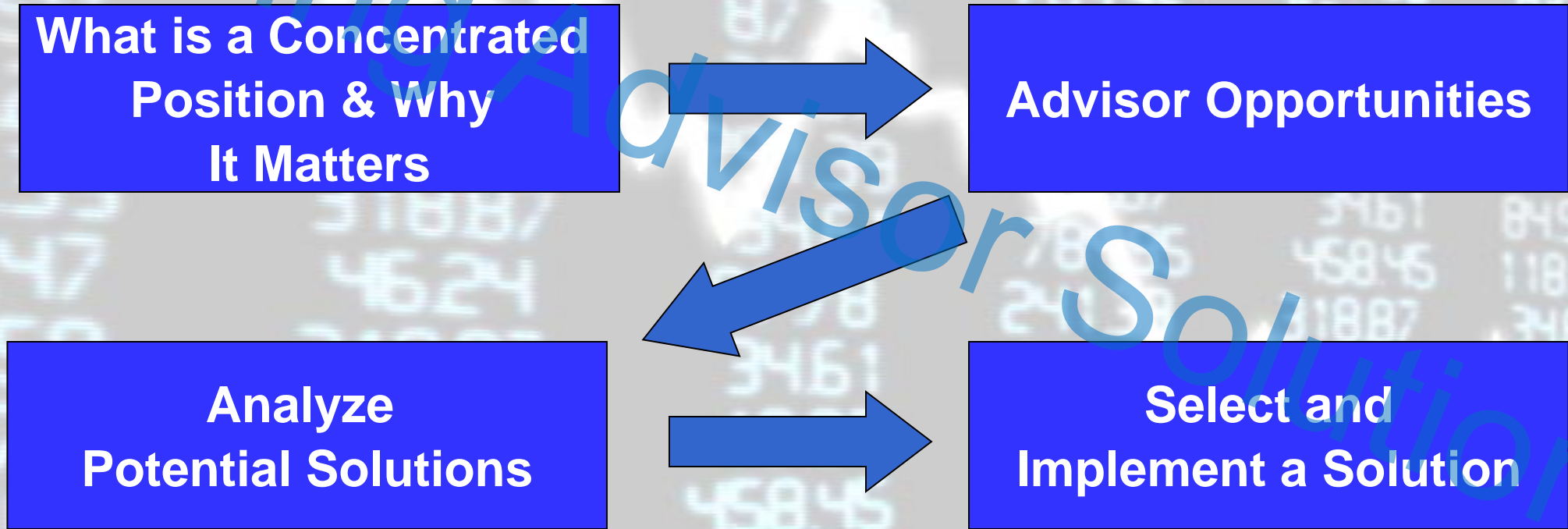
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Concentrated Holdings

Opportunities for Advisors

Disclosures These disclosures highlight some of the issues raised by the creation of a Sterling FundPower Trust and other issues potentially raised in this presentation. Sterling Foundation Management, LLC, (“Management”) and Sterling Donor Advised Fund, Inc. (“Fund”) (collectively, Management and Fund are referred to hereinafter as “Sterling”) provide this disclosure only for your convenience, and the convenience of your legal, tax and investment advisors in considering the creation of a trust. Any such creation would ultimately take place pursuant to the terms of a written trust instrument (“Trust”). References to “you” or “your” refer to the retirement plan owner, the assets of which plan are intended or contemplated to fund a Trust. There are a number of considerations related to the creation of a Trust that you should discuss with your advisors. The value of the financial interest in the Trust may be affected by a number of factors, including but not limited to: your age at death; the age(s) of Trust beneficiary(ies) upon your death; the health of your beneficiary(ies); the payout rate of the Trust; the future returns earned on Trust assets; the tax treatment of your Trust payouts (ordinary income, capital gains, state taxes) and the effective tax rates thereon. We note the following as a way for you to begin to consider along with your team of advisors including tax and legal advisors the suitability of a Trust. Life Expectancy. The Trust is a split interest trust and as such the ultimate financial value of the lead interest may be subject to mortality risk. All such mortality risk will ultimately be borne by the beneficiary(ies) and/or their heirs. Upon the expiration of the term of the Trust, the remaining Trust assets, if any, will pass to Fund. While you or your heirs can nominate a donor advisor, such an advisor by law may have no ability to legally bind the donor advised fund account. Investment Rates of Return. The ultimate cash distributions from the Trust will depend, to a significant extent, on the investment returns earned by the Trust during its term. Such investment returns are inherently uncertain. The past performance of the markets is no guarantee of future performance. All projected investment returns in this presentation are for illustrative purposes only, and are not a prediction or guarantee of future performance, and may not accurately represent the future rates of return and/or the future rates of applicable taxation and/or various fees and/or excise taxes or other governmental or non-governmental fees or costs that might arise or apply in the future. Taxation. The Trust is expected to last for a period of multiple decades. Any illustration involving taxation is made under the assumption that current tax rates and policies continue into the future; however, no representation or warranty of any kind regarding the applicability now or in the future of such assumptions is express or implied. The actual tax impact of a Trust on beneficiaries may vary. You should consult with qualified tax advisors. Additionally, various assumptions, which may or may not be appropriate, have been made about current tax laws, current tax incidence, and likely future rates, laws and incidences. Expenses, Fees and other Charges. A Trust may be subject to certain setup and management or administration fees. Any such fees illustrated herein are believed to be representative of current fee schedules in place, but are not a guarantee or warranty of such current fees or future fees. **NEITHER STERLING NOR YOUR INVESTMENT PROFESSIONAL IS PROVIDING YOU WITH TAX OR LEGAL ADVICE.** Neither Sterling nor the Investment Professional nor the affiliated firm introducing this presentation is providing you any tax or legal advice in connection with any aspects of any proposed creation of a Trust or other disposition or plan with respect to your IRA, 401(k), 403(b), or other qualified or non-qualified plan or other assets. You should consult with your own tax and legal advisory team in connection with the proposed creation of a Trust, and not rely on Sterling, your financial advisor or the financial firm (whether broker/dealer or registered investment advisor) for such advice.

What You'll Learn



Causes of Concentrated Positions

Early investor in Great Performers

E.g.

Apple

Amazon

MSFT

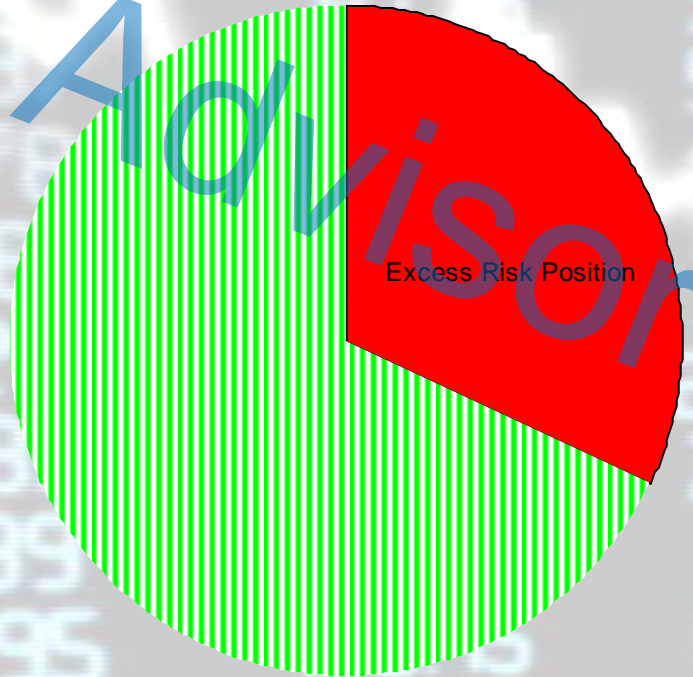
NFLX

Employment Related Stock

Concentrated holdings are more common than often understood

Employment Related Concentrations

Average Equity Compensated Employee



Source: Schwab

What is a Concentrated Position?

Key Concept:
Diversifiable Risk

▶ Technical Definition: Any position that results in “return-free risk”

Selected S&P Stocks That Have Dropped at Least 70%



Between 1980 and 2020, 40% of the Russell 3000 Lost at Least 70% at Some Time

Expected Return

Consider a \$1,000 Bet on a Coin Flip

Heads = \$1300

Tails = \$900



Expected Value = $\frac{1}{2} \times \$1300 + \frac{1}{2} \times \$900 - \$1000 = \$1,100$

Risk

Standard Deviation → Measures Range of Outcomes

Heads = \$1300

Tails = \$900



Standard Deviation = $(\frac{1}{2} \times (1300-1100)^2 + \frac{1}{2} \times (900-1100)^2)^{\frac{1}{2}} = \200

Diversification

Bet Same \$1000 Total, in 100 Identical Small Bets

Heads = \$13

Tails = \$9



Expected Value = $100 \times \left[\frac{1}{2} \times \$1300 + \frac{1}{2} \times \$900 - \$1000 \right] = \$1,100$

Diversification Reduces Risk

Same Total, Broken into 100 Identical Small Bets

Heads = \$13

Tails = \$9



Standard Deviation of a Single Bet = $\left[\frac{1}{2} \times (13-11)^2 + \frac{1}{2} \times (9-11)^2 \right]^{1/2} = \2

Measuring Risk

Same example, in percentage terms

Heads = + 30%

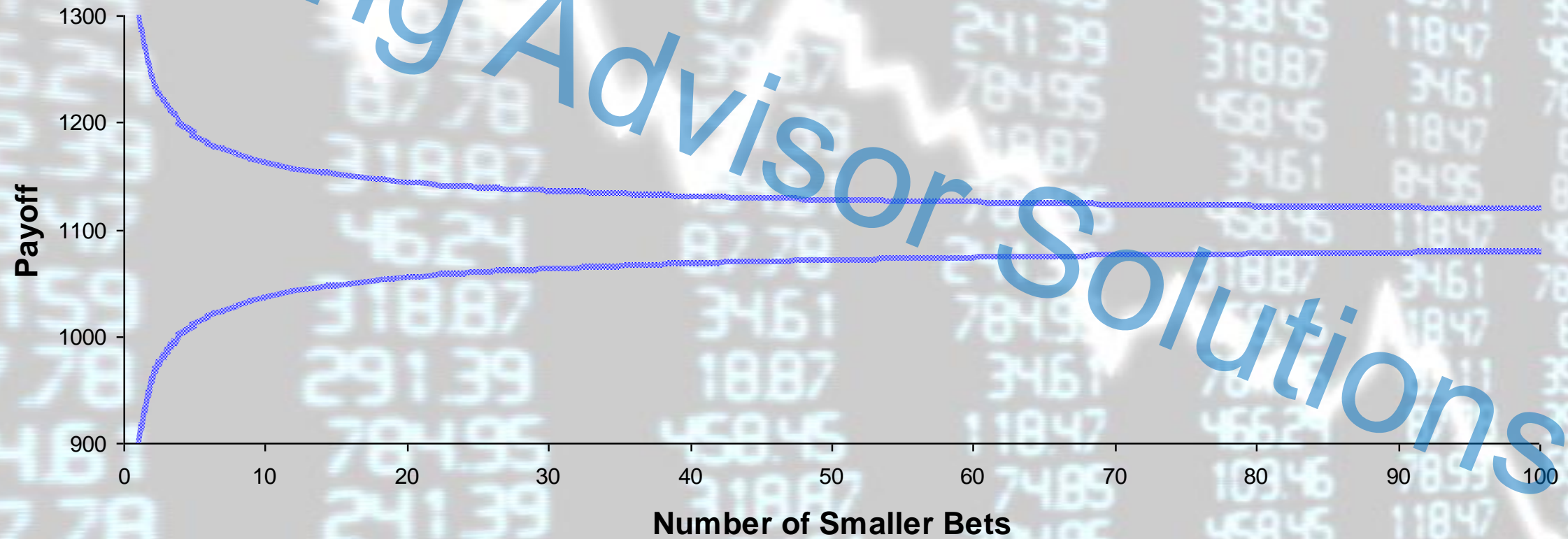
Tails = -10%



Standard Deviation = $\left[\frac{1}{2} \times (.3 - .1)^2 + \frac{1}{2} \times (-.1 - .1)^2 \right]^{1/2} = .2 = 20\%$

Multiple Smaller Bets Reduce Risk

How Diversification Reduces Risk



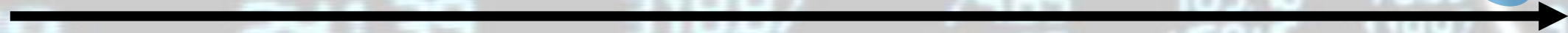
Most Assets are Positively Correlated

Correlation Reduces the Effectiveness of
Diversification

$$\sigma = \sqrt{\frac{\sigma^2}{n} + \sigma^2 \rho - \frac{\sigma^2}{n}}$$

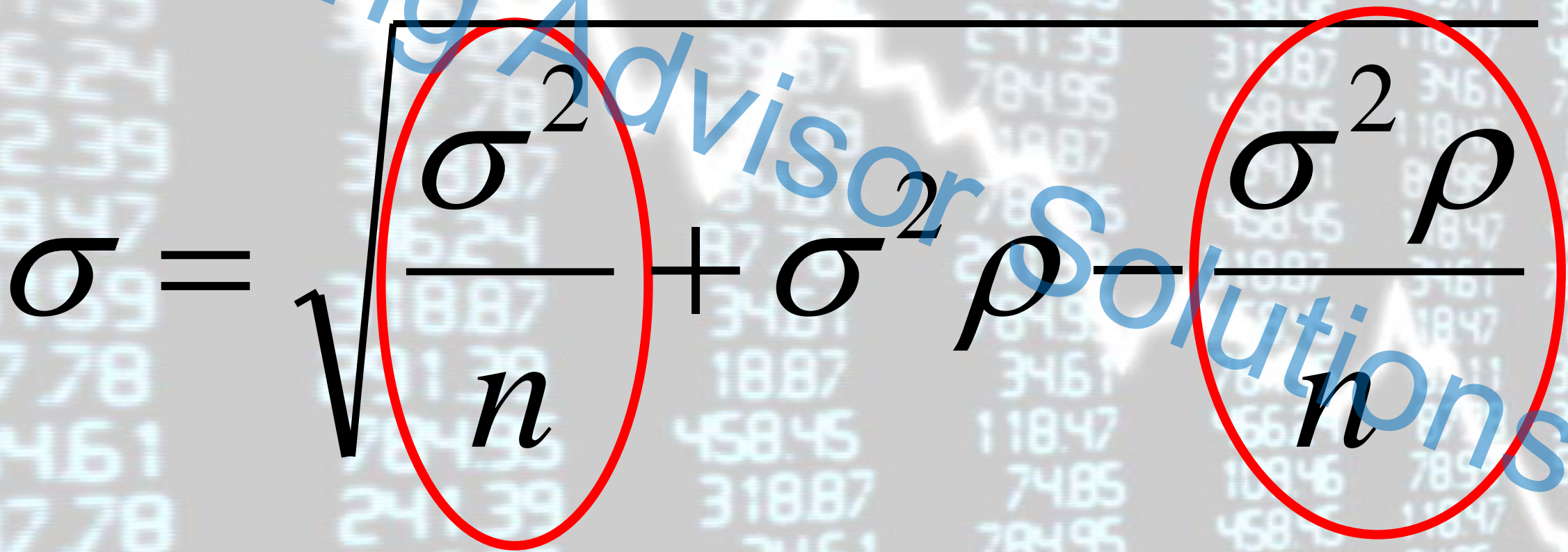
A Fraction Goes to Zero as Denominator Gets Large

$$\frac{1}{1} \quad \frac{1}{10} \quad \frac{1}{100} \quad \frac{1}{1000}$$



Value Approaches Zero as Denominator Grows

As n Grows, Circled Terms Shrink

$$\sigma = \sqrt{\frac{\sigma^2}{n} + \sigma^2 \rho \frac{\sigma^2}{n}}$$


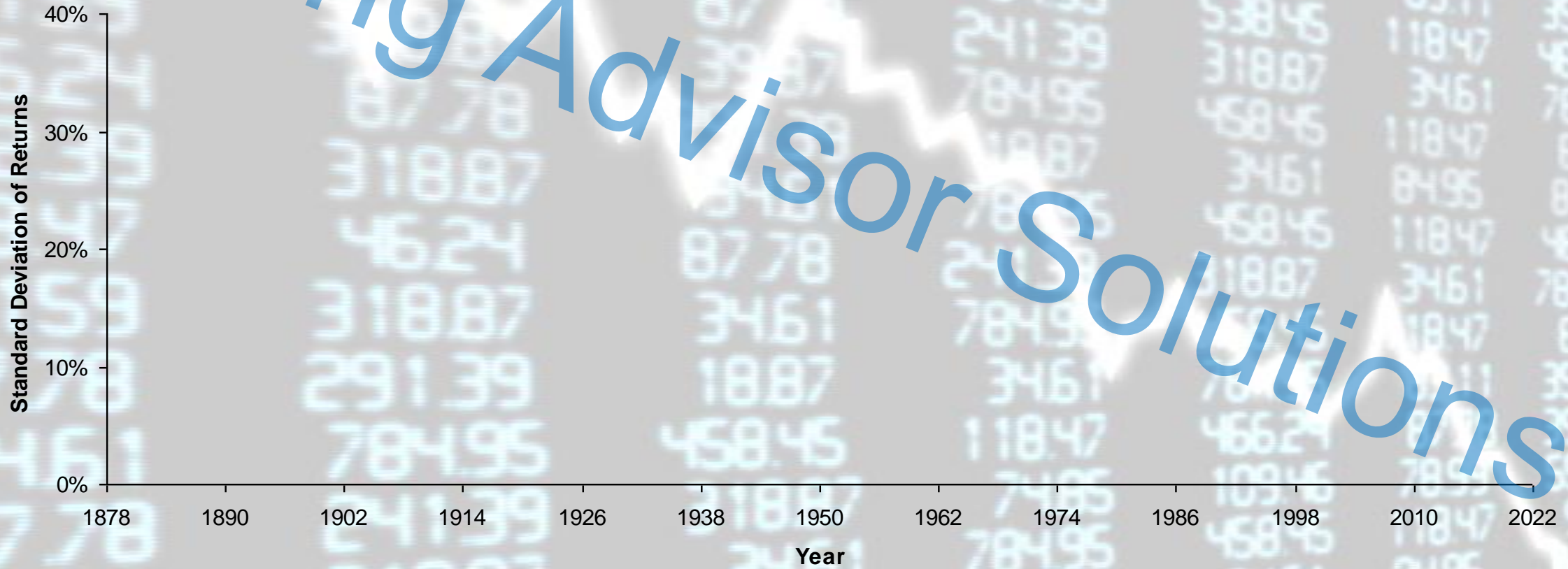
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Risk is Minimized When Diversification is Maximized

$$\lim_{n \rightarrow \infty} \sigma = \sqrt{\sigma^2 \rho}$$

Correlation → Non-Diversifiable Risk

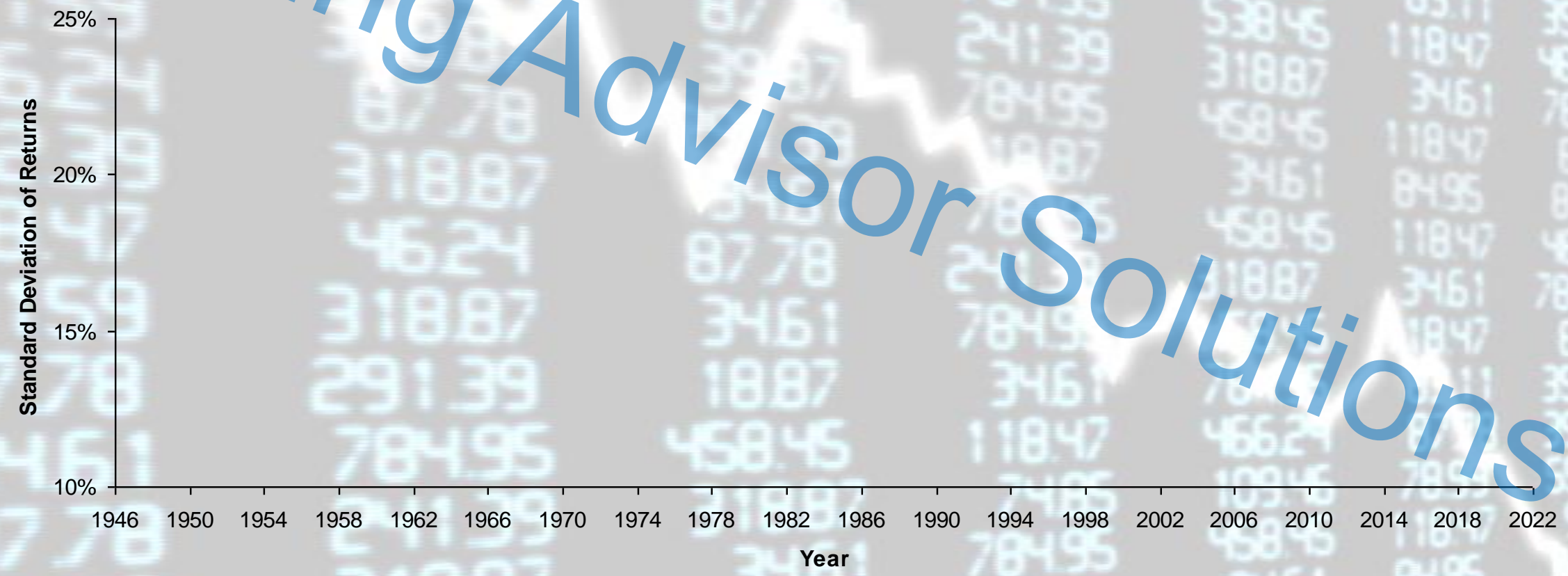
US Stock Market 10 Year Average Standard Deviation of Returns



Non-Diversifiable Risk

Average Std. Dev. 17.5% Since End of WW II

US Stock Market 10 Year Average Standard Deviation of Returns



Theoretical Calculation of Market σ

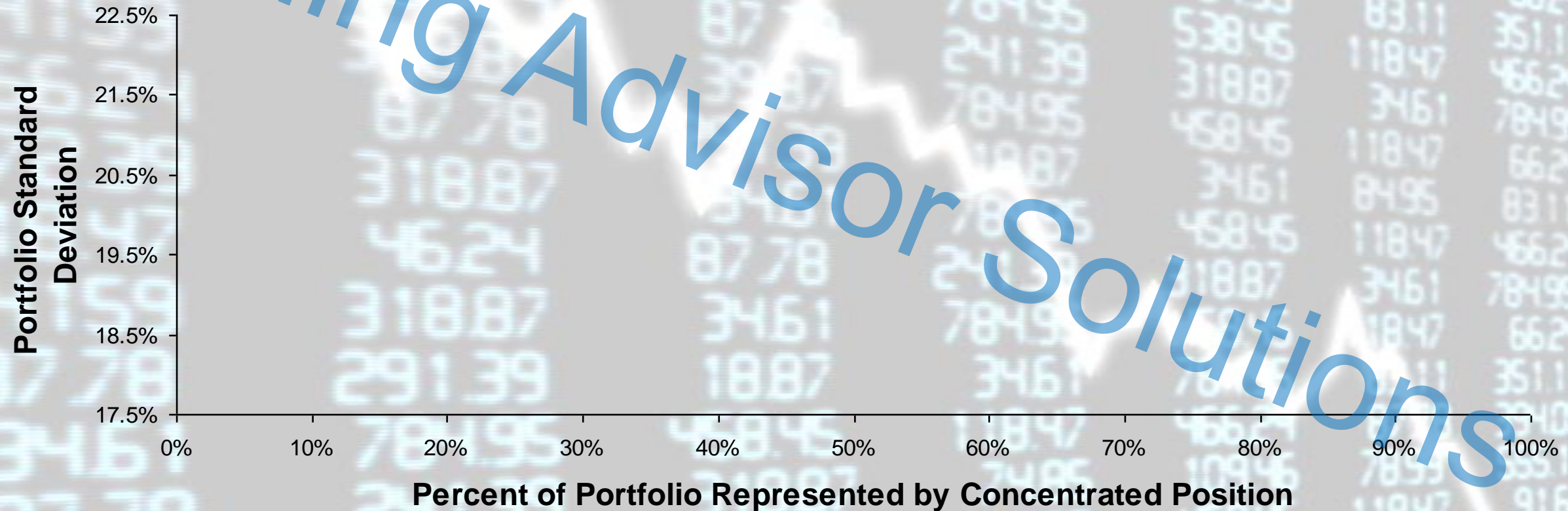
Standard Deviation of Average Stock ~ 22.5%

Average Correlation ~ 0.6

$$\sqrt{.225^2 \times 0.6} = .174 = 17.4\%$$

Concentration Increases Risk

Portfolio Standard Deviation as a Function of Concentration
Assumes: Mkt SD = .175; Concentrated Position SD = .225; Correlation = 0.6



Arithmetic return

Geometric or Compound return

Effect of Standard Deviation on Compound return

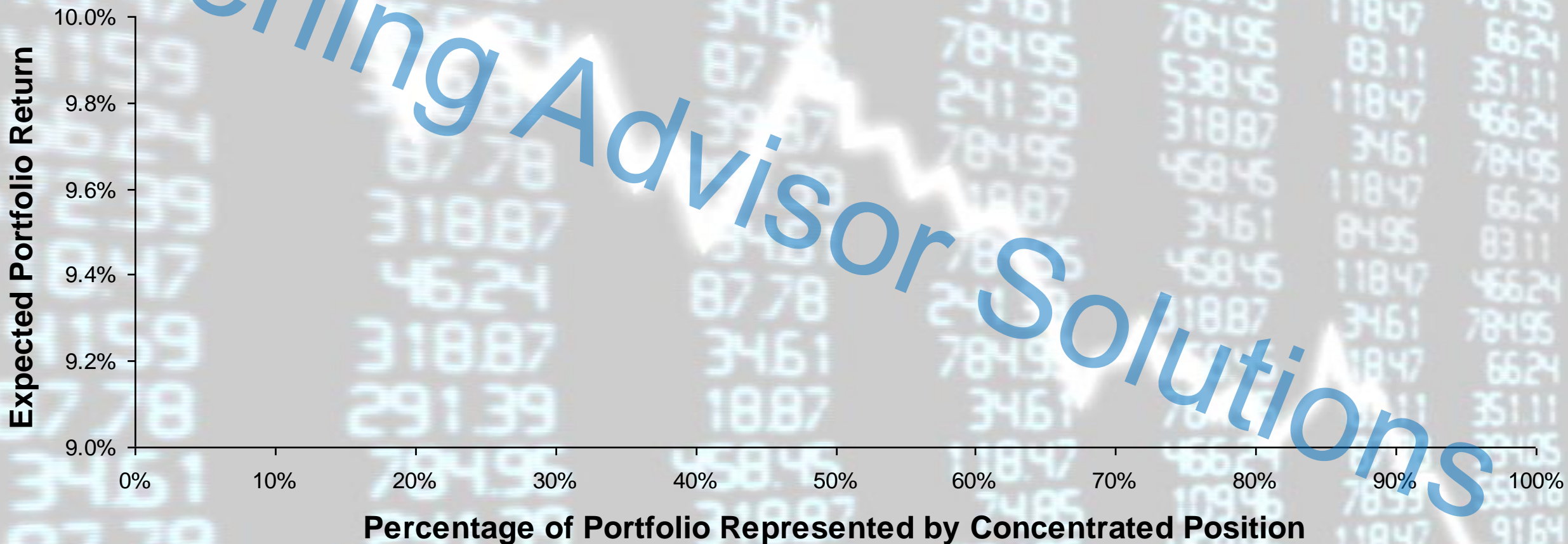
Example

Year	Index	Arithmetic	Compound or Geometric
0	100	-	-
1	125	25%	25%
2	100	-20%	-20%
Average		2.5%	0%

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$$g = \mu_a - \frac{\sigma_a^2}{2}$$

Concentrated Position Reduces Expected Return



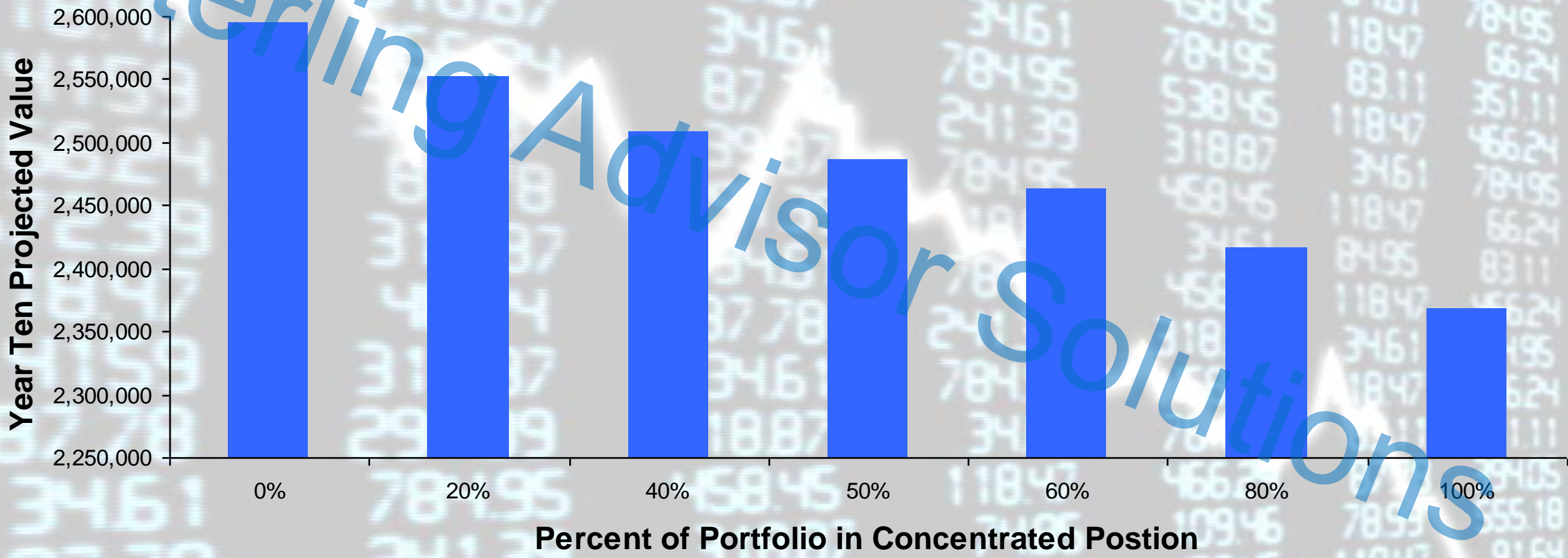
Rule of Thumb

For **Every 10%** of the Portfolio in a Concentrated Holding

Expected Total Return on the Entire Portfolio

Decreases by .1% per Year

Value of \$1 Million in Ten Years vs. Degree of Concentration



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Taxes

Emotion

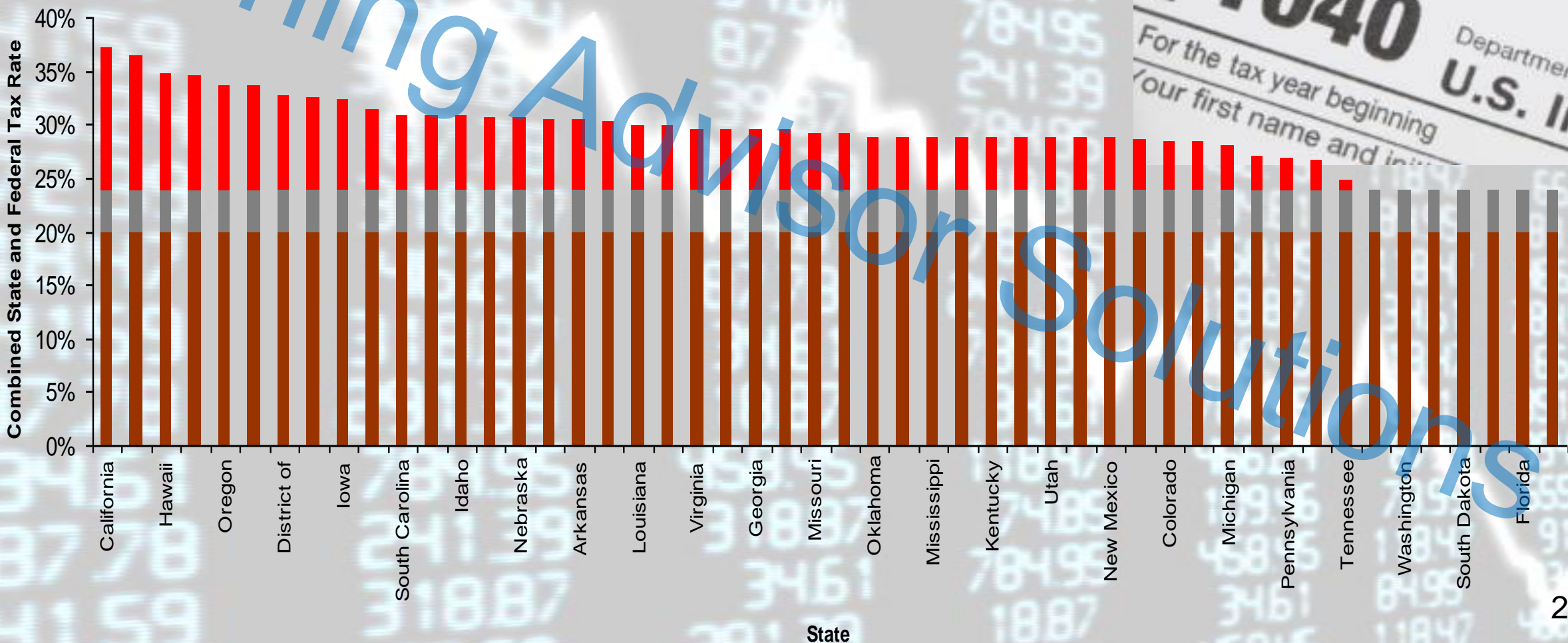


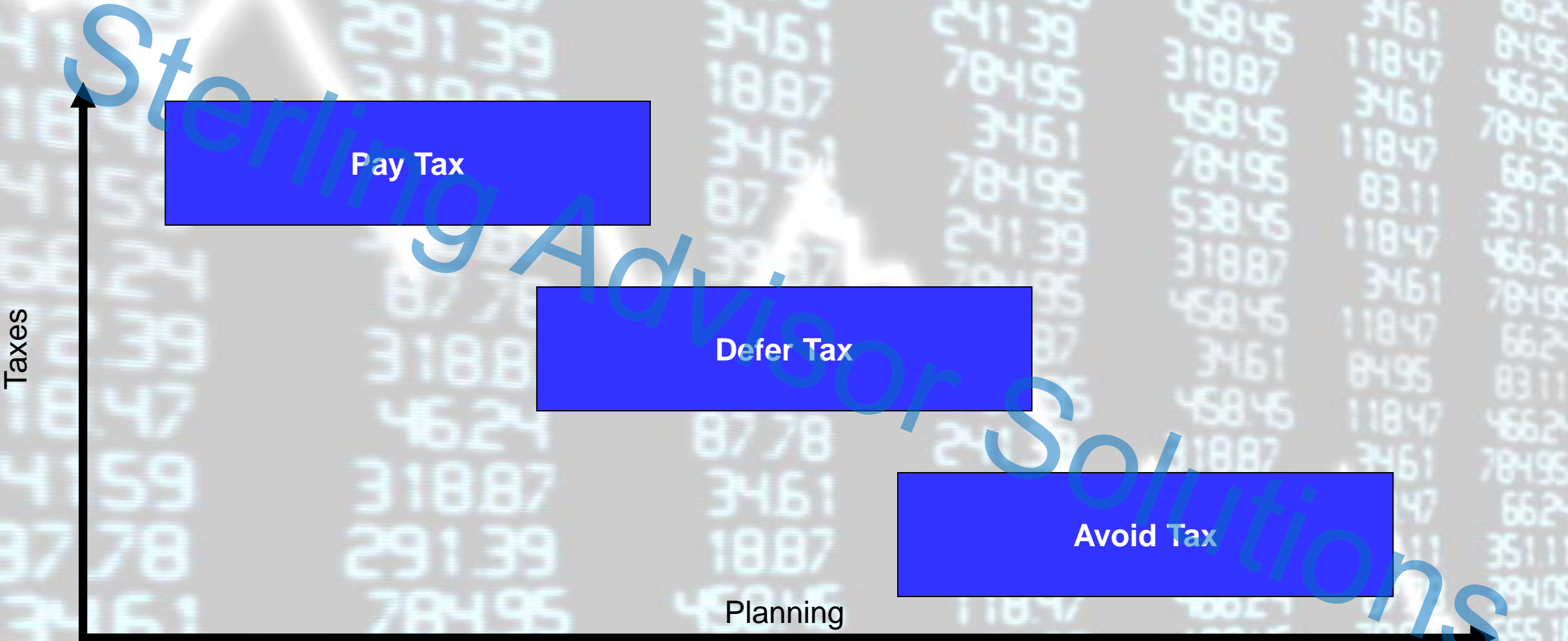
Habit

Inertia



Effective Tax Rate by State





Effective planning saves taxes and adds value

Hedging

- Publicly Traded Put Options
- Collar
- Private Put Options
- Prepaid Variable Forwards
- Single Stock Futures

Diversification

- Outright Sale
- Sales over Time
- Exchange Fund
- Sec 664 Stock Diversification Trust

Taking a Position Opposite to the Position Already Held

- Complex
- Costly
- For less than one year time horizons

▶ A limited tool that should be used primarily by and for professionals

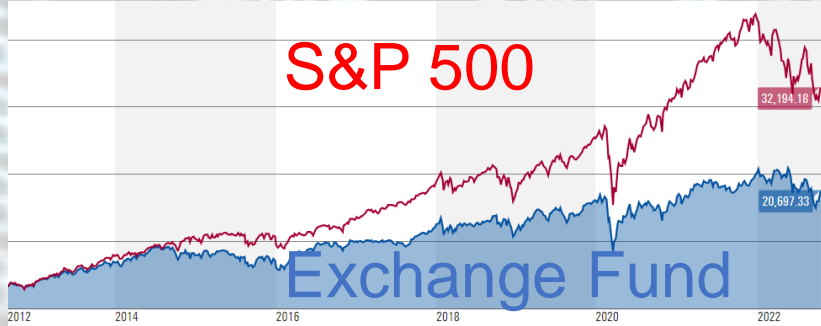
Outright Sale

- Costly – full taxes
- No limitations on after-tax proceeds

Best for clients who do not have concerns about paying tax

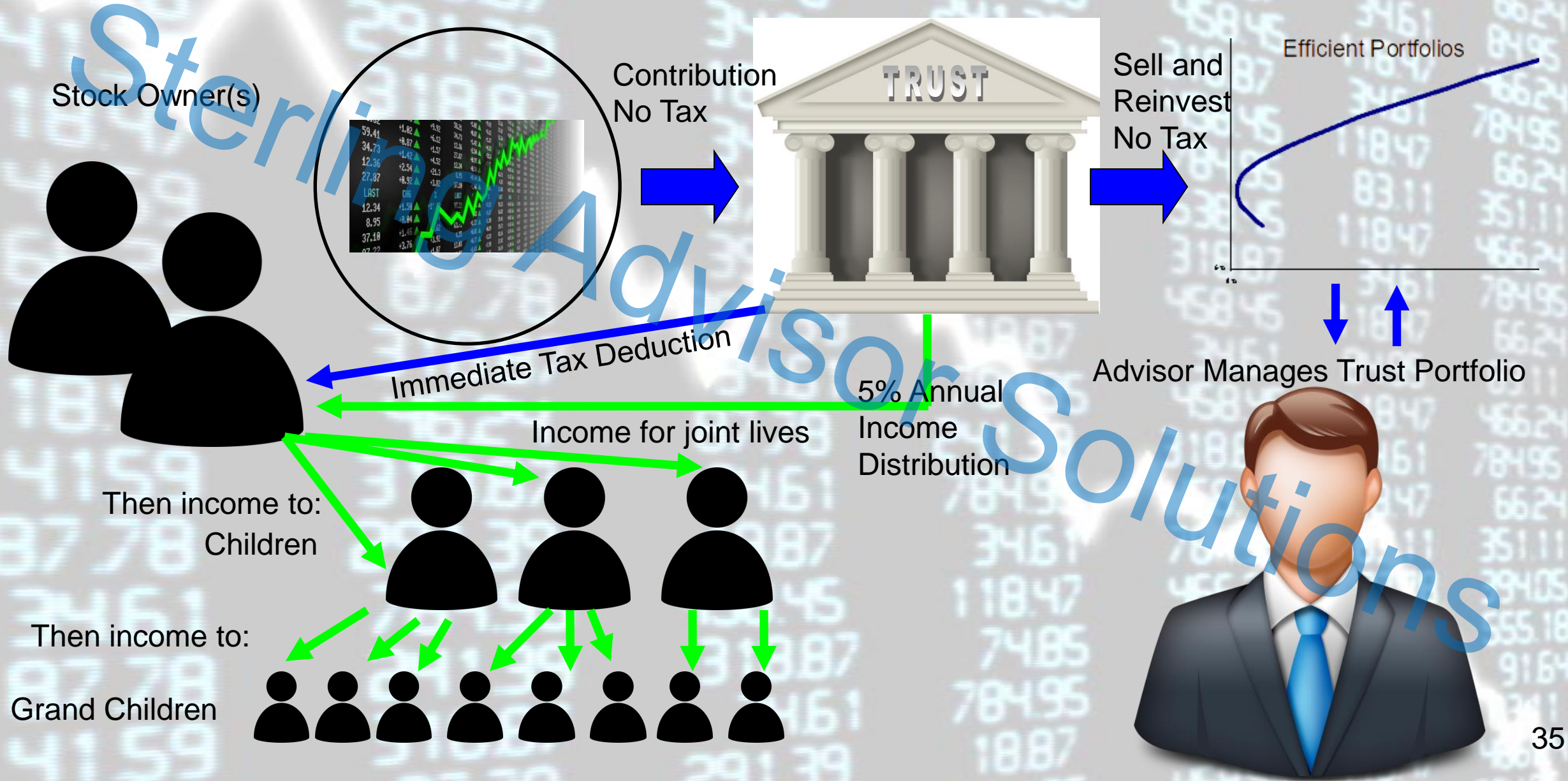
Exchange Fund

- Costly – Upfront fees
- Risky – Adverse Selection
- Historical Poor Returns
- Limited Ability to Change Investments

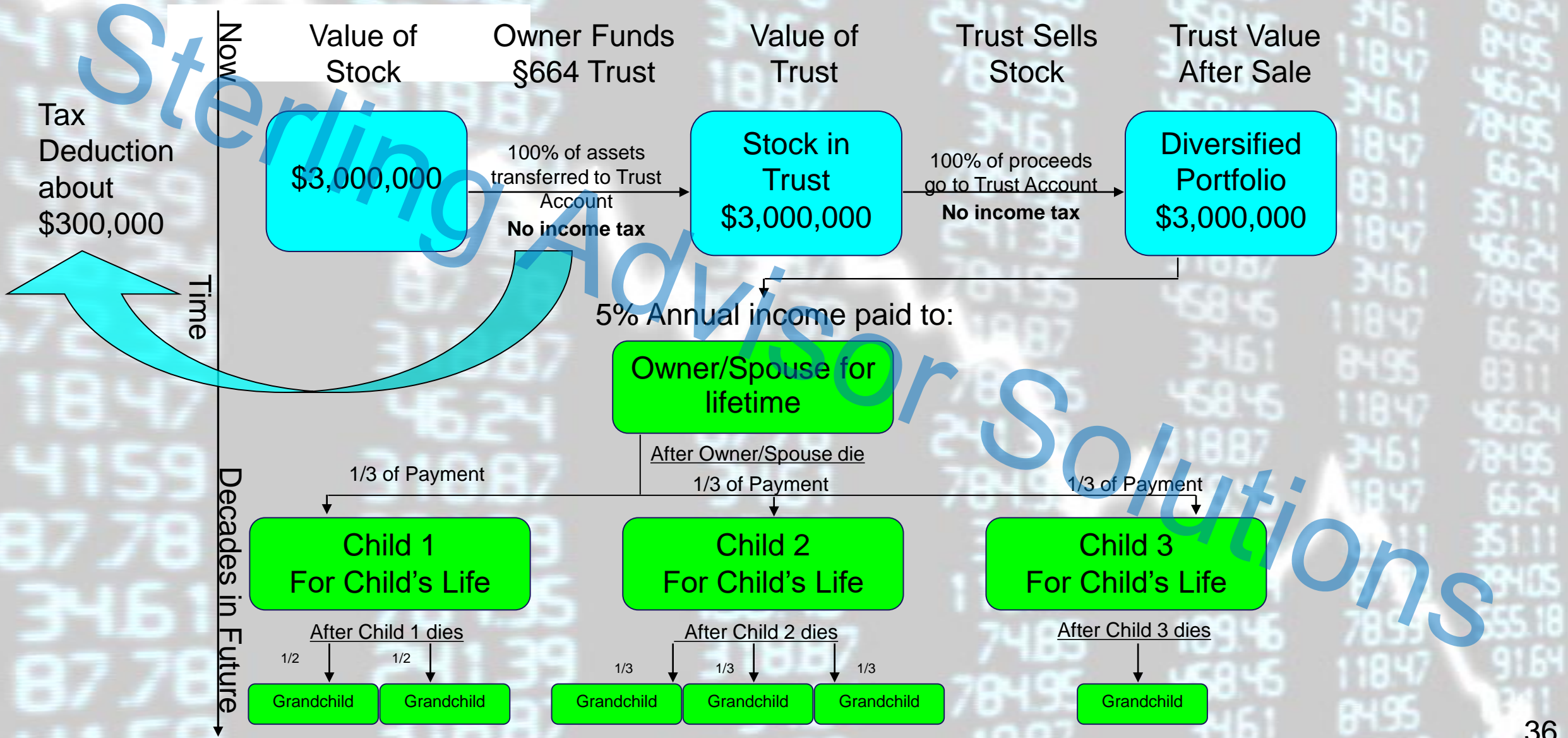


▶ Rarely, if ever, the best solution for your client

§664 Stock Diversification Trust



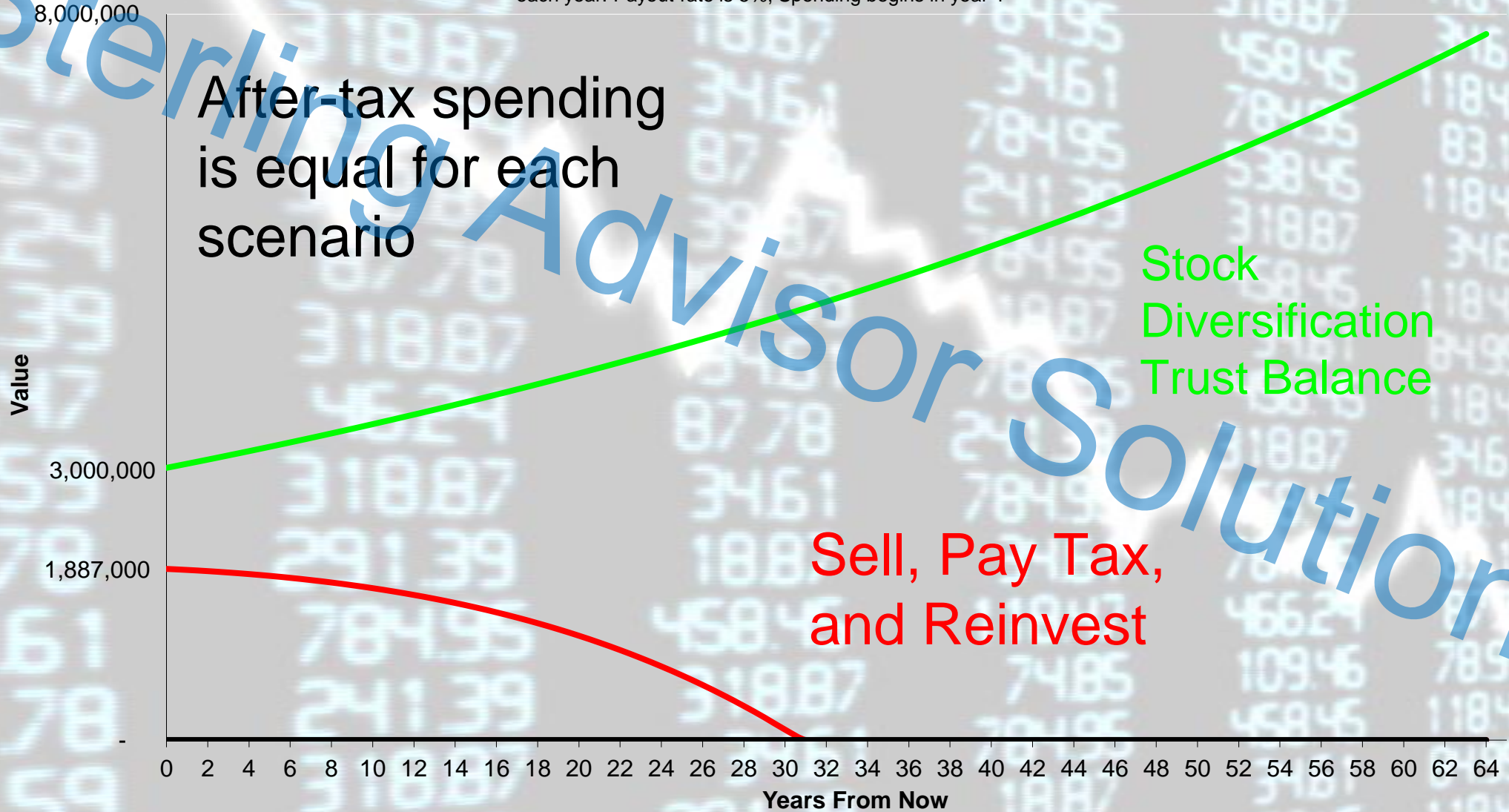
§664 Stock Diversification Trust



This is an example only, and does not necessarily represent any specific client situation. At the conclusion of the life of the last beneficiary, or the final term of the trust, the remaining assets will go into a donor advised fund account. The term of each trust will be a function of the ages of the beneficiaries living at the time of the client's death, and the applicable IRS tables and rules.

Total Wealth: \$664 Stock Diversification Trust vs. Sell, Pay Tax & Reinvest

Key Assumptions: Asset Value: \$3,000,000.; Basis: \$0.; Effective Cap Gain Tax Rate: 37.1%; Growth Rate: 7%; Trust Costs 0.5%; For Taxable Account, growth is taxed each year. Payout rate is 5%, Spending begins in year 1

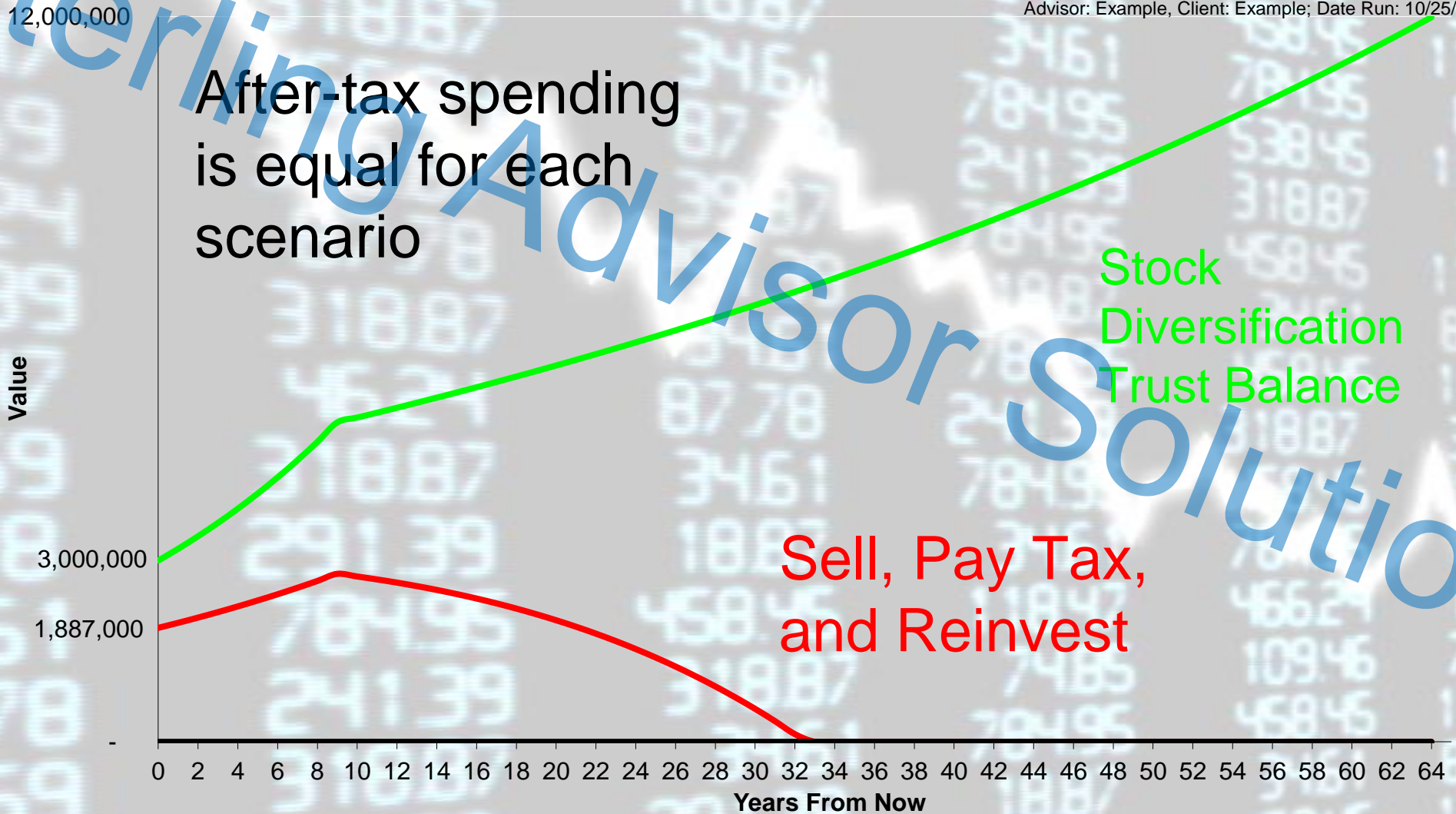


This graph illustrating the implications of assumptions, some listed others not, is provided for the convenience of you and your advisors. It is not a forecast. It is based on assumptions and methods that are believed to be reasonable, but includes known simplifications including but not limited to the use of a single average annual rate of return and constant tax rates. No warranty explicit or implied. © Sterling Foundation Management, LLC

Total Wealth: **\$664 Stock Diversification Trust vs. Sell, Pay Tax & Reinvest**

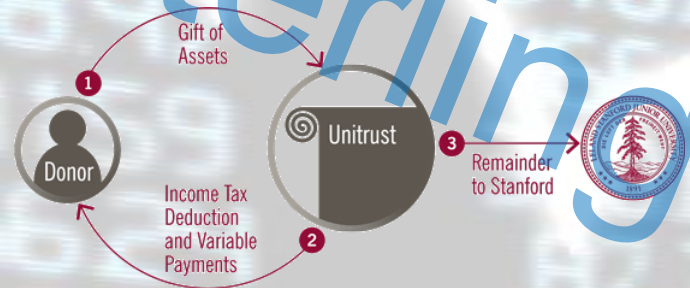
Key Assumptions: Asset Value: \$3,000,000.; Basis: \$0.; Effective Cap Gain Tax Rate: 37.1%; Growth Rate: 7%; Trust Costs 0.5%; For Taxable Account, growth is taxed each year. Payout rate is 5%, Spending begins in year 10

Advisor: Example, Client: Example; Date Run: 10/25/22



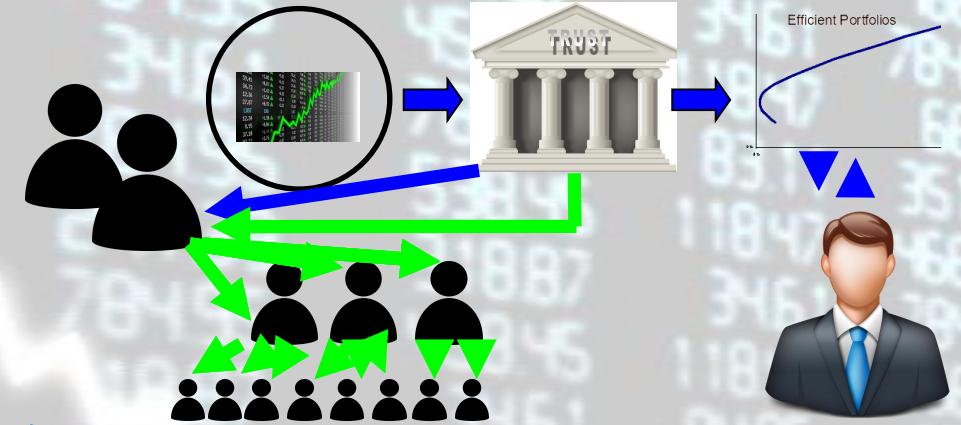
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A Traditional Charitable Remainder Trust



is to:

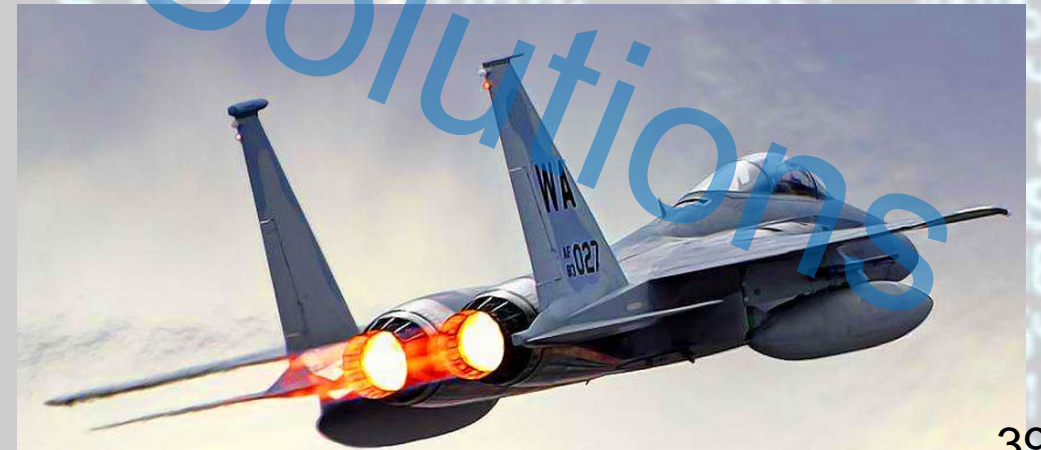
A §664 Stock Diversification Trust



AS



is to:



Benefits

- Tax free contribution of stock**
- Stock sold without tax**
- Assets can be reinvested in fully diversified portfolio**
- Annual cash distributions if desired**
- Indefinite deferral if desired**
- Can last for up to three generations**
- Assets protected from creditors**
- Easy and cost effective to implement**

Limitations

- Requires professional administration**
- Trust is irrevocable**
- Beneficiaries entitled to income only**
- Income is taxable when received by beneficiary**

A §664 Trust is often an excellent solution for stockholders who want to avoid tax

Summary of Alternatives

	Outright Sale	Sales Over Time	Exchange Fund	664 Trust
Taxable	Yes	Yes	No	No
Tax Deduction	No	No	No	Yes
Investment Flexibility	Maximum	Risk is Retained with Stock	No	Maximum
Access to Principal	Yes	Limited by cash flow	With sale and tax	No
Asset Protection	No	No	No	Yes
Tax Free Deferral	No	No	No	Yes

Technique	Best Used When
<i>Outright Sale</i>	There is no concern about taxes
<i>Sales Over Time</i>	Diversification is not important; Relatively small \$
<i>Exchange Fund</i>	If investor loves the other stocks in the fund; rare
<i>664 Trust</i>	Taxes, investment flexibility, diversification matters

Concentrated Stock

Examples:

- Current employee owns too much company stock
- Former employee owns too much company stock
- Diversification important but sale will incur too much tax
- Successful past investment as created large concentrated position

Concentrated Stock

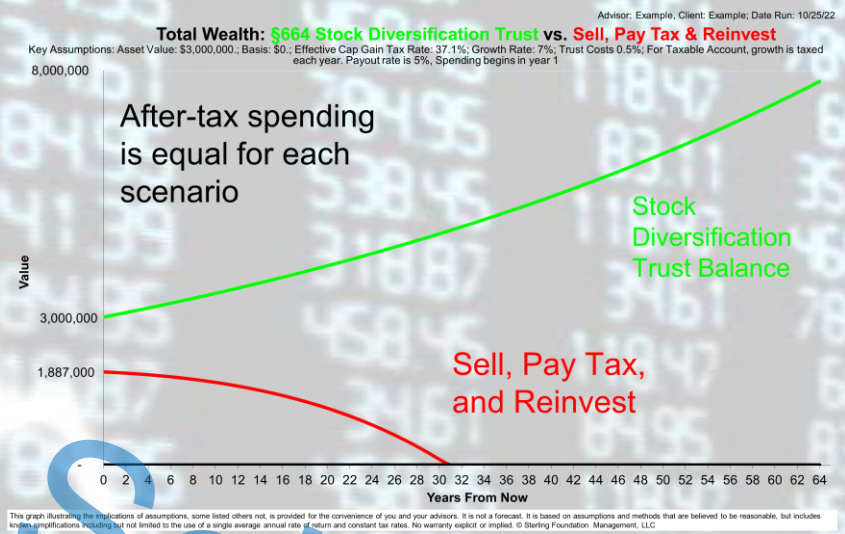
What to look for:

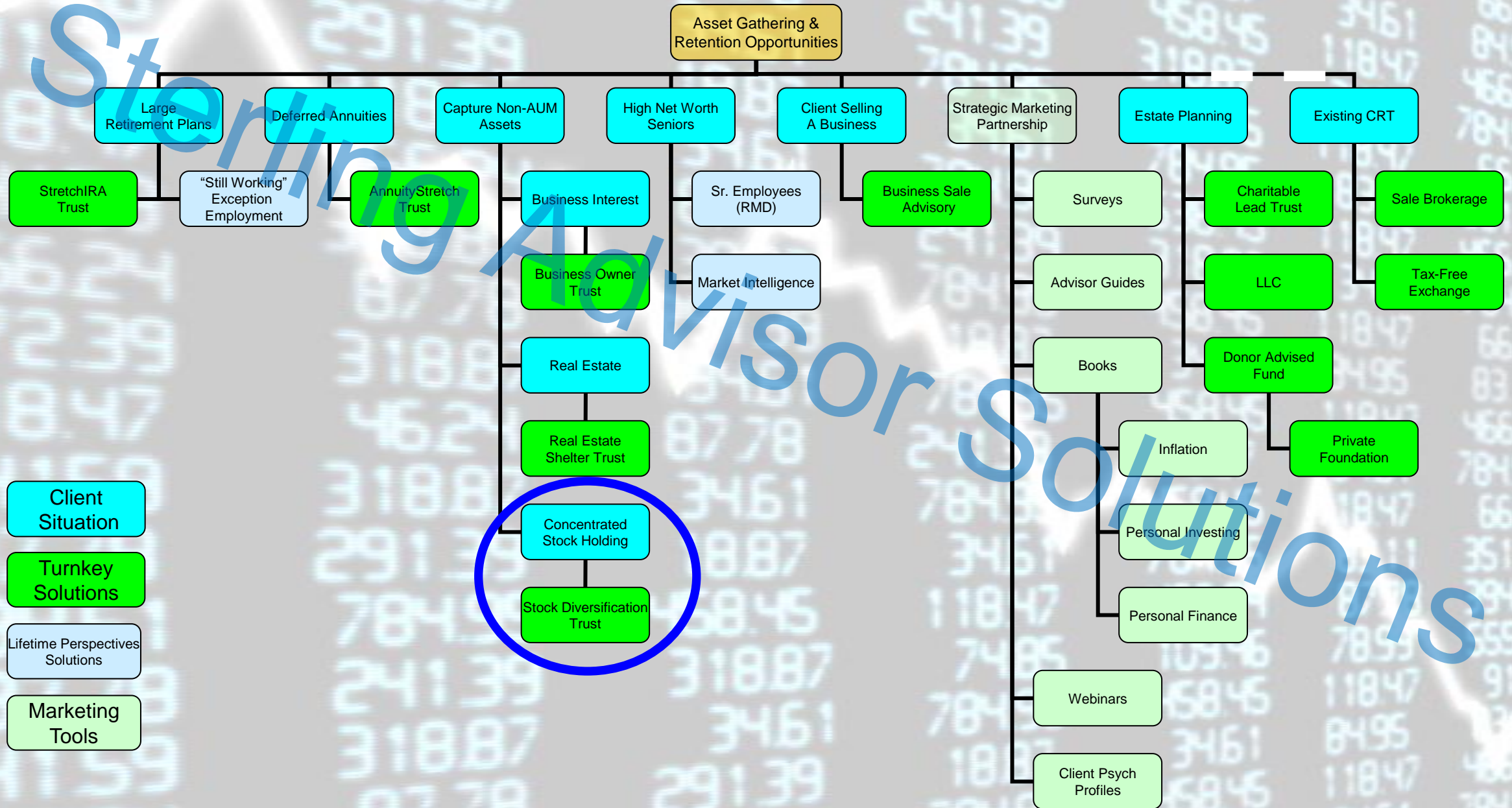
1. Clients with concentrated position
2. Info to put together
 1. Approximate market value of position
 2. Approximate basis
 3. Amount of debt, if any
 4. Ownership method (e.g. personal, LLC, partnership)
 5. Owner main goals (e.g. save taxes, diversify, cashflow)
3. Is there a spouse, children, grandchildren?

Concentrated Stock

We'll Give You:

1. Individualized analysis
2. Consultation, discussion, review
3. Turnkey documents





- Client Situation
- Turnkey Solutions
- Lifetime Perspectives Solutions
- Marketing Tools

Appreciated Real Estate
A Sterling Advisor Guide
2022



Authoried by:
Roger Silk Ph.D., C.F.A., Chief Executive Officer
Ryan Whiting, Business Analyst
Connor Barth, Business Analyst




Selling a Business
A Sterling Advisor Guide
2022




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Concentrated Stock Positions
A Sterling Advisor Guide
2022




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Large Retirement Plans
A Sterling Advisor Guide
2022



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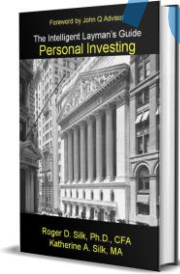
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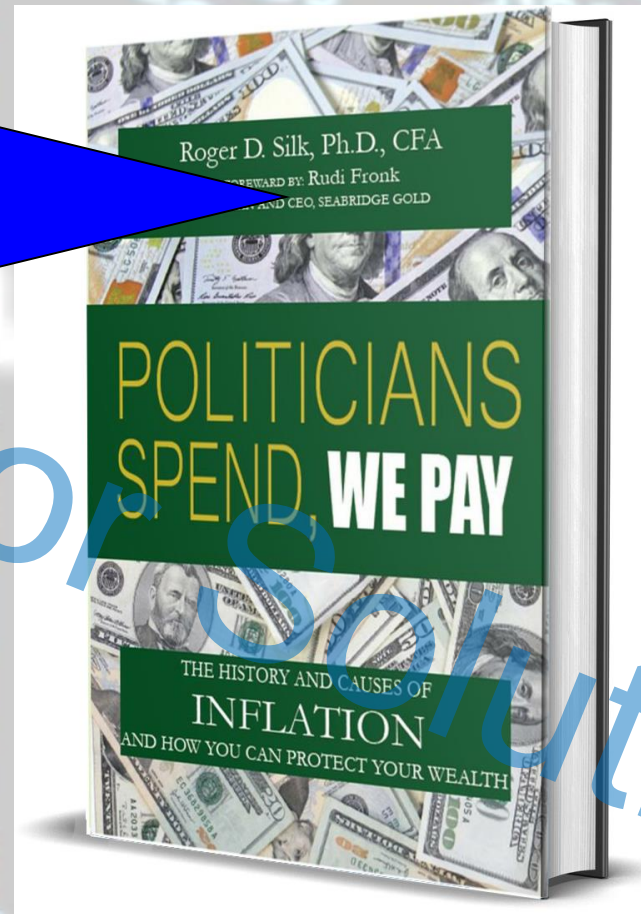
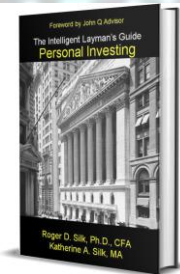
Your Name Here

Forthcoming titles:

The Intelligent Layman's Guide to Personal Investing



The Intelligent Layman's Guide to Personal Finance





Strategic Growth Partnership Program

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