BERNSTEIN

# How Much Is Too Much?


Andrew Bishop, CFA
Colleen McBride

***“How much is too much?”*** It’s a common question among those who have accumulated a significant concentration in a particular company’s stock, whether from employer-granted shares, savvy investment decisions, or an inheritance. It’s exciting to see wealth appreciate on paper. But real wealth is only created once an investment has been sold—and unfortunately, no one can time that decision precisely.

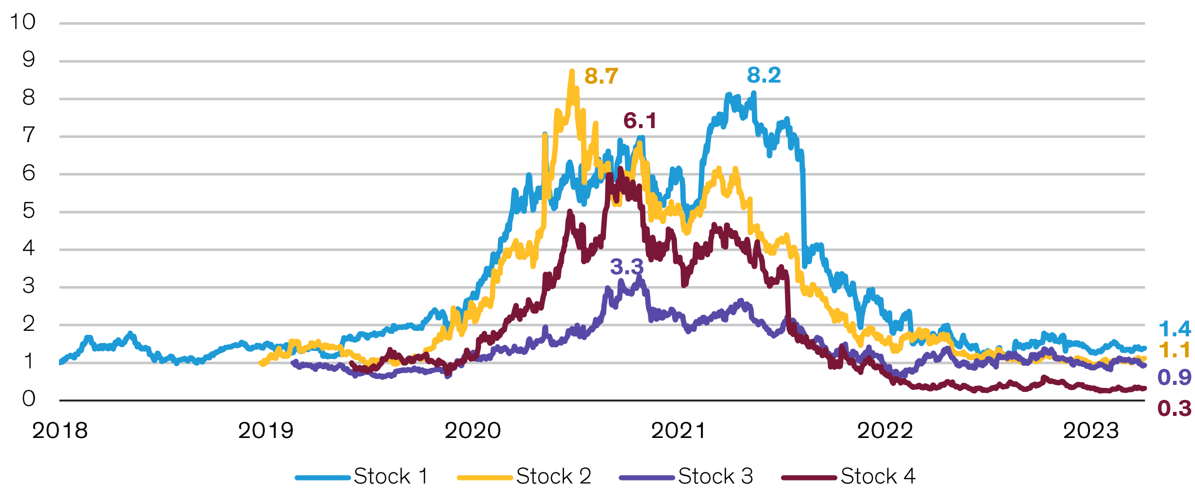
History is littered with examples of “paper millionaires,” but in reality, few investors actually achieve this status because timing the decision to sell is a challenge. This is especially true for public company employees who may experience a Fear of Missing Out (FOMO). Do you want to be the one employee who sells early only to miss out on potential mounting profits? While concentration can lead to wealth, diversification is key to maintaining it.

Throughout history, there have been numerous instances of popular stocks that have experienced tumultuous rides. Unfortunately, some investors in these companies have gone from being quite wealthy to having nothing, assuming they never sold along the way (**Display 1**). For example, an investor in Stock 2 who initially had $1.0 million when the company went public would have seen their paper wealth soar to $8.7 million at its peak. However, if they held onto their shares and never sold, they would be left with just $1.1 million—a modest $100,000 gain.

**DISPLAY 1: THE WILD RIDE OF A STOCK INVESTOR**

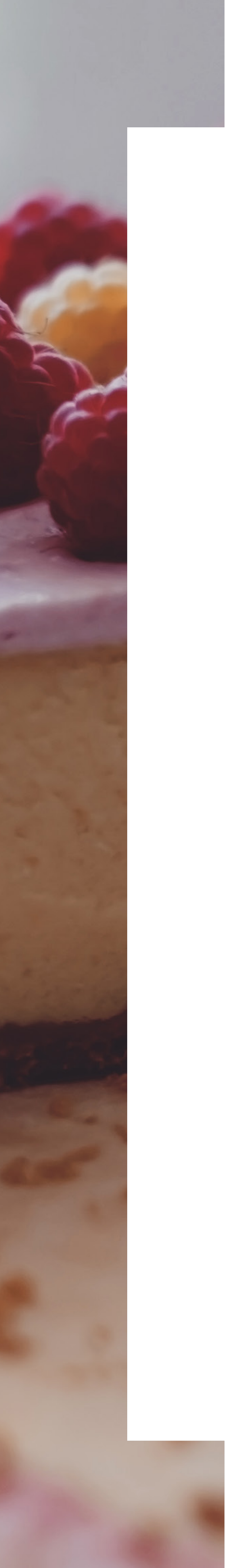
From IPO Through July 31, 2023*

USD in Millions




**Past performance does not guarantee future results.**

*Historical prices for certain stocks from IPO through July 31, 2023. Values assume investor had $1.0 million worth of the stock at the time of the IPO.



What's more, not every publicly traded company stays public forever; some companies are acquired while others go bankrupt. Consider the following statistics[1]:

- The average lifespan of listed companies in the S&P 500 was just over 21 years as of 2020, compared to over 30 years in 1965.
- By 2026, the average lifespan is expected to drop to just 14 years.

It's easy to look back and conclude that you should have sold before the stock price fell, but hindsight is 20/20. And for some, selling seems inconceivable. These investors may feel an emotional attachment to their shares, hold certain biases (**Display 2**), or just loathe the thought of the tax hit. As a result, most investors tend to hold their stock too long. Yet studies have shown that viewing such decisions through an analytical lens can help overcome biases and secure better outcomes.*

## DISPLAY 2: PSYCHOLOGICAL BARRIERS TO DIVERSIFICATION

| Bias | Description | Investor Behavior |
|---|---|---|
| Anchoring | Assuming the future will be like the past | Expect continued outperformance from single stock: HOLD STOCK |
| Overconfidence | Overrated ability to predict uncertain occurrences | Single stock seen as a known and successful entity: HOLD STOCK |
| Attraction to long shots | Overestimating occurrence of positive low-probability events (like winning the lottery) | Lure of big win: HOLD STOCK |
| Underestimating the likelihood of extreme events | Overly discounting the probability of unusually good and unusually bad outcomes | The possibility of life-changing negative results ignored: HOLD STOCK |
| Regret avoidance | Regret for taking action more intense than regret for negative consequences of taking no action | Single stock may continue to appreciate, which would cause regret had it been sold: HOLD STOCK |
| Reference dependency | Inappropriate reference point may influence decision-making | The reference point for a single stock tends to be its highest price, and so selling a stock at a lower price feels like a failure: HOLD STOCK |
| Taking outsized risk to avoid loss | Incurring large risks to avoid a sure loss | Avoid taxes attendant on diversifying: HOLD STOCK |

*Source: Daniel Kahneman (Nobel Price winner in economics) and Amos Tversky.

1 https://www.statista.com/statistics/1259275/average-company-lifespan/
https://www2.deloitte.com/content/dam/Deloitte/us/Documents/deloitte-analytics/us-consulting-exponential-enterprise.pdf

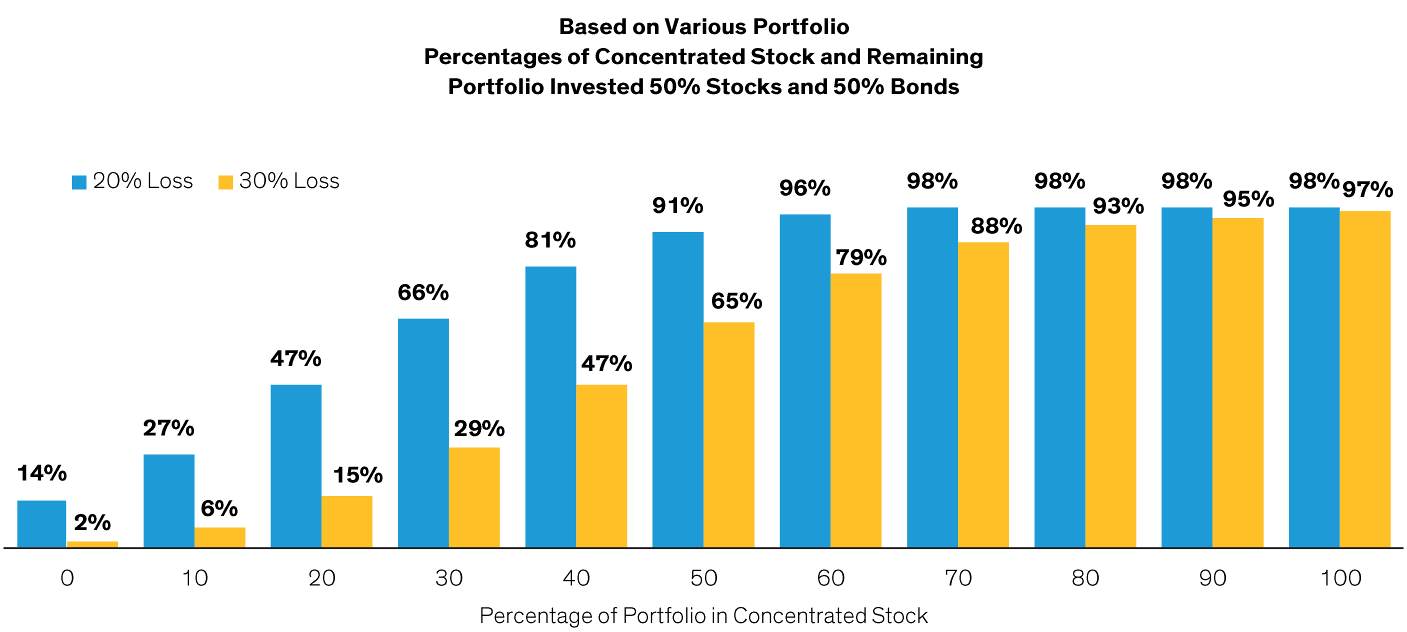
## Sizing up concentration risk

Stocks are the return-seeking component of an asset allocation, serving as the engine for growth. But at what point does concentration become an issue? In other words, at what point does a single stock represent too much risk for an investor? Our analysis indicates that the likelihood of experiencing a peak-to-trough loss of 20% or 30% increases significantly when a stock represents more than 20% of the portfolio. Once the holding exceeds 50%, the results are almost certain (**Display 3**).

At what point does a single stock represent too much risk for an investor?

**DISPLAY 3: DEFINING CONCENTRATION RISK**

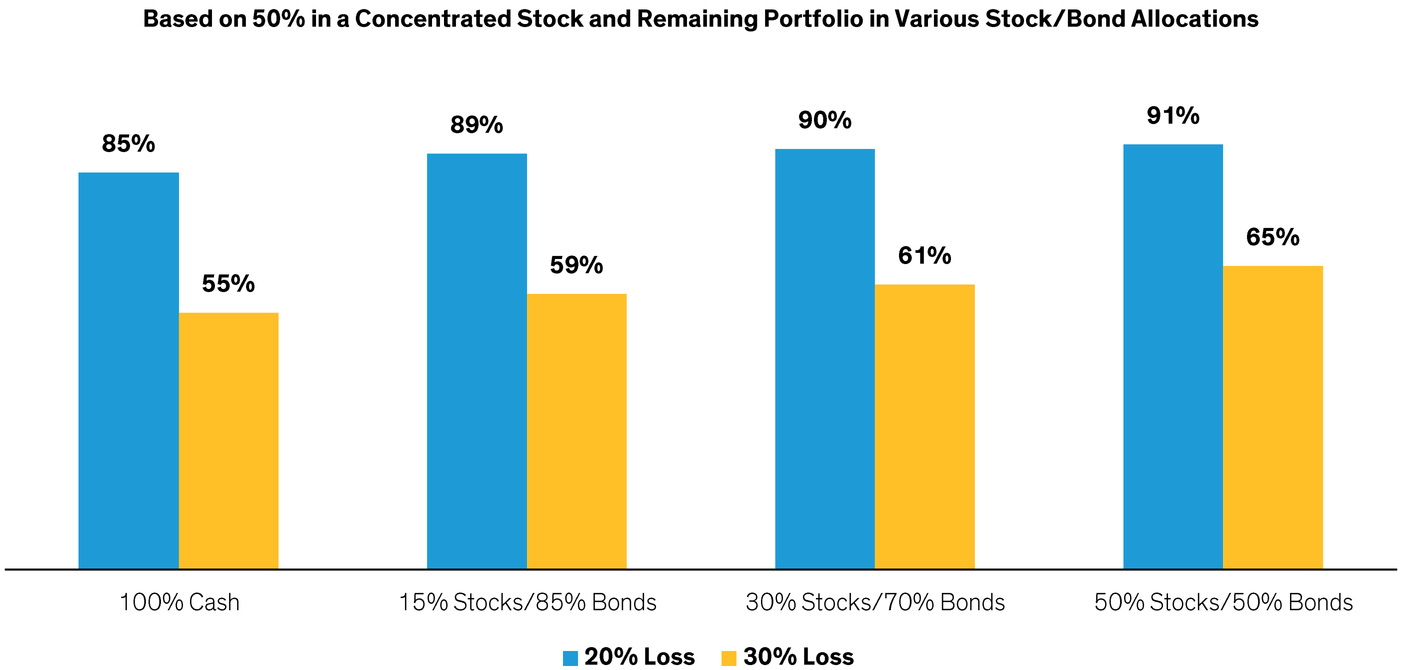
Probability of a 20% or 30% Peak-to-Trough Loss*




*Projections indicate the probability of a peak-to-trough decline in pretax, pre-cash-flow cumulative returns of 20% or 30% over the next 20 years based on different percentages of the portfolio allocated to a concentrated stock with the remaining assets invested in a diversified portfolio of 50% global stocks and 50% bonds. Analysis was based on a stock with a volatility of 28%, a beta of 1.05, and a dividend of $1.5 per share. Because the Wealth Forecasting System uses annual capital-market returns, the probability of peak-to-trough losses measured on a more frequent basis (such as daily or monthly) may be understated. The probabilities depicted above include an upward adjustment intended to account for the incidence of peak-to-trough losses that do not last an exact number of years. Based on AB's estimates of the range of returns for the applicable capital markets over the next 20 years. Data do not represent past performance and are not a promise of actual future results or a range of future results. See Notes on the Wealth Forecasting System for further details.

**DISPLAY 4: DEFINING CONCENTRATION RISK**

Probability of a 20% or 30% Peak-to-Trough Loss*




*Projections indicate the probability of a peak-to-trough decline in pretax, pre-cash-flow cumulative returns of 20% or 30% over the next 20 years based on 50% of the portfolio being in a concentrated stock and the remaining 50% invested with an asset allocation of 100% cash, 15% global stocks and 85% bonds, 30% global stocks and 70% bonds, or 50% global stocks and 50% bonds. Because the Wealth Forecasting System uses annual capital-market returns, the probability of peak-to-trough losses measured on a more frequent basis (such as daily or monthly) may be understated. The probabilities depicted above include an upward adjustment intended to account for the incidence of peak-to-trough losses that do not last an exact number of years. Based on AB's estimates of the range of returns for the applicable capital markets over the next 20 years. Data do not represent past performance and are not a promise of actual future results or a range of future results. See Notes on the Wealth Forecasting System for further details.

Another common misconception is that concentration risk can be mitigated by allocating the remaining portion of your portfolio more conservatively. However, the concentrated stock position will ultimately drive the overall volatility of an investor's portfolio regardless of the allocation of the remaining portion (**Display 4**). As we've previously discussed, while concentration can be rewarding, it can also be painful. Simply allocating more conservatively is not enough.

For some investors, recognizing concentration risk is only half the battle. The question then becomes: when is the best time to diversify, especially if the stock has recently come down from its high? Selling now may feel like leaving money on the table, so waiting a little longer to get back to the previous high-water mark may seem like a better option. Yet, there's always the risk that the stock may never regain its value.

It's not unusual for a single stock to experience large drawdowns. Since 2000, the average large-cap US stock has suffered a 5% drawdown 20 times and a 20% drawdown four times (**Display 5**). What's more, recovering from these losses takes time. On average, it takes a stock 142 days to recoup a 5% loss and over a year to rebound from a 20% drawdown. And some stocks never fully regain their lost value. In fact, 73.5% of stocks trade below their all-time high one year later, and 20% of stocks are still trading below their all-time high even after 10 years. Put another way, an investor who waits for a stock to return to its high-water mark could be waiting for a long time.

### An all-or-nothing proposition?

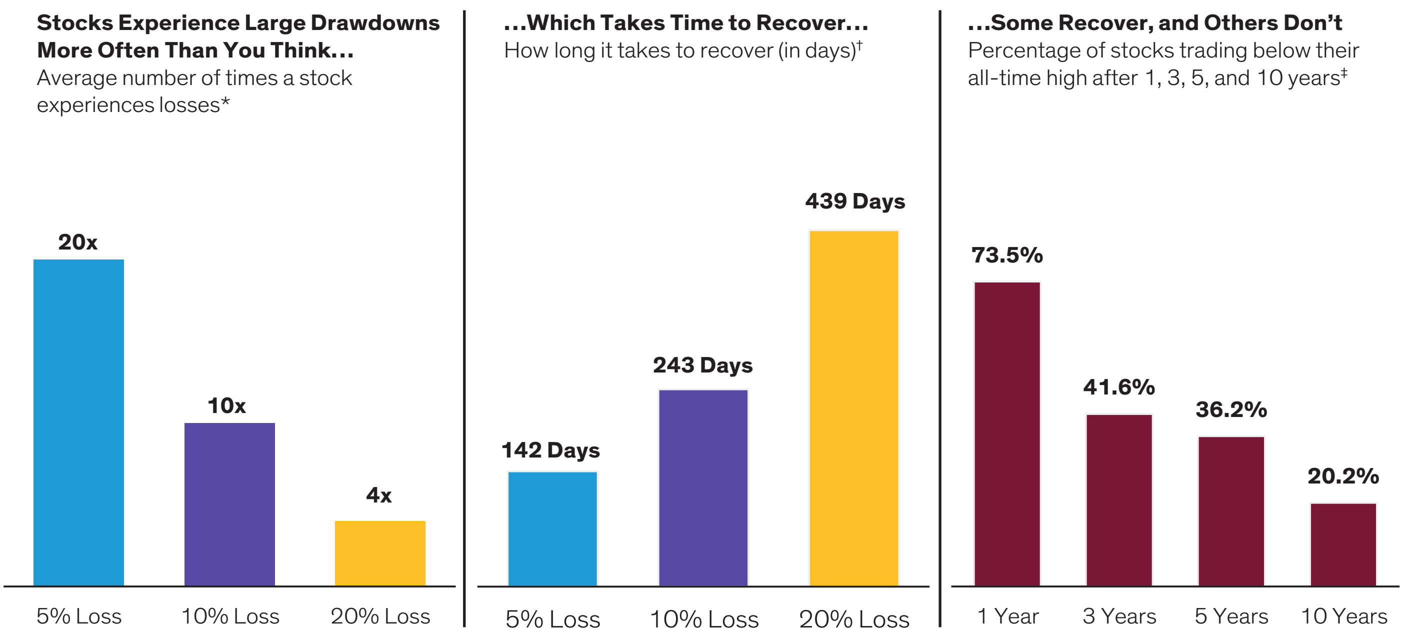
Some investors may find comfort in selling the stock over time—as opposed to all at once—to avoid missing the potential upside. Yet there's a trade-off in doing so. Consider an investor with a $5 million stock position and a cost basis of zero. Their concerns about selling too soon and leaving profits on the table conflict with worries about the stock continuing to decline in value. Should they sell now, over time, or wait? We analyzed the impact of the following strategies:

- Sell 100% of the stock now
- Sell equal portions each year for five years
- Sell 50% of the stock now and the remaining 50% in equal portions each year over the following four years
- Sell 100% of stock at the end of five years

An investor who waits for a stock to return to its high-water mark could be waiting for a long time.

**DISPLAY 5: LARGE DRAWDOWNS ARE NOT UNCOMMON**

Number of Losses and Time to Recover




**Past performance does not guarantee future results.**

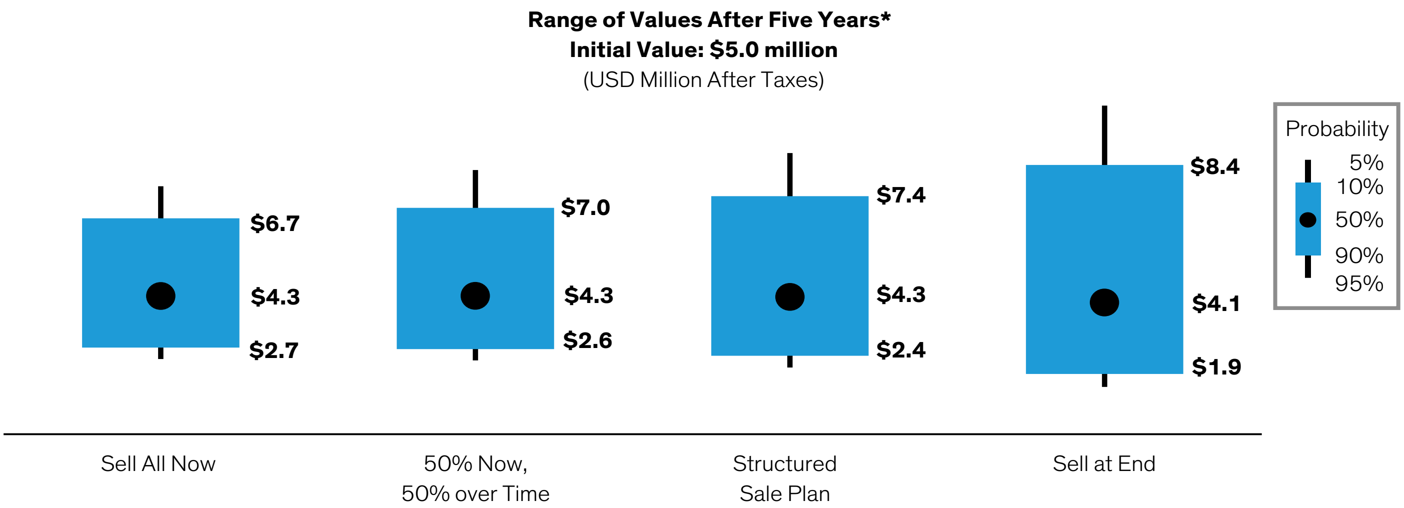
*Represents the average number of times a stock in the S&P 500 experienced a 5%, 10%, or 20% drawdown from January 1, 2000, to August 2023.

†Represents the average number of days it took a stock in the S&P 500 that experienced a 5%, 10%, or 20% drawdown to recover from January 1, 2000, to August 2023.

‡Represents the number of stocks that are trading below their all-time high after 1 year, 3 years, 5 Years, or 10 years. Source: CRSP US Stock Databases and AB, which included all of the S&P 500 components from January 1, 2000, to August 2023.

**DISPLAY 6: LONG-TERM VS. NEAR-TERM SELLING COMPARISON**

Selling Shares Now Offers Attractive Risk Reduction with Modest Impact to Median Return




*Based on Bernstein's estimates of the range of returns for the applicable capital markets over the next five years. After-tax dividends and sale proceeds are assumed to be invested in 100% US diversified equities. Values are net of embedded capital gains tax. Assumes cost basis of $0. Data do not represent any past performance and are not a promise of actual future results. See Notes on Wealth Forecasting System for further details.

Source: AB

The results were interesting (**Display 6**). Selling 100% now provides the best risk mitigation (notice that the bottom of this box doesn't dip as far as the others), but it delivers the least amount of upside (as the top of this box doesn't reach as high). In contrast, holding the stock yields the biggest upside—but the worst downside if we experience poor markets. It's impossible to predict the best time to sell, so we typically advise selling enough stock at once to meet an investor's core capital needs. Core capital is the amount required to endow your lifetime spending. Once core capital is met, investors can be more patient or opportunistic with their surplus capital or even consider using the stock for wealth transfer opportunities.

## Taxes, what a drag

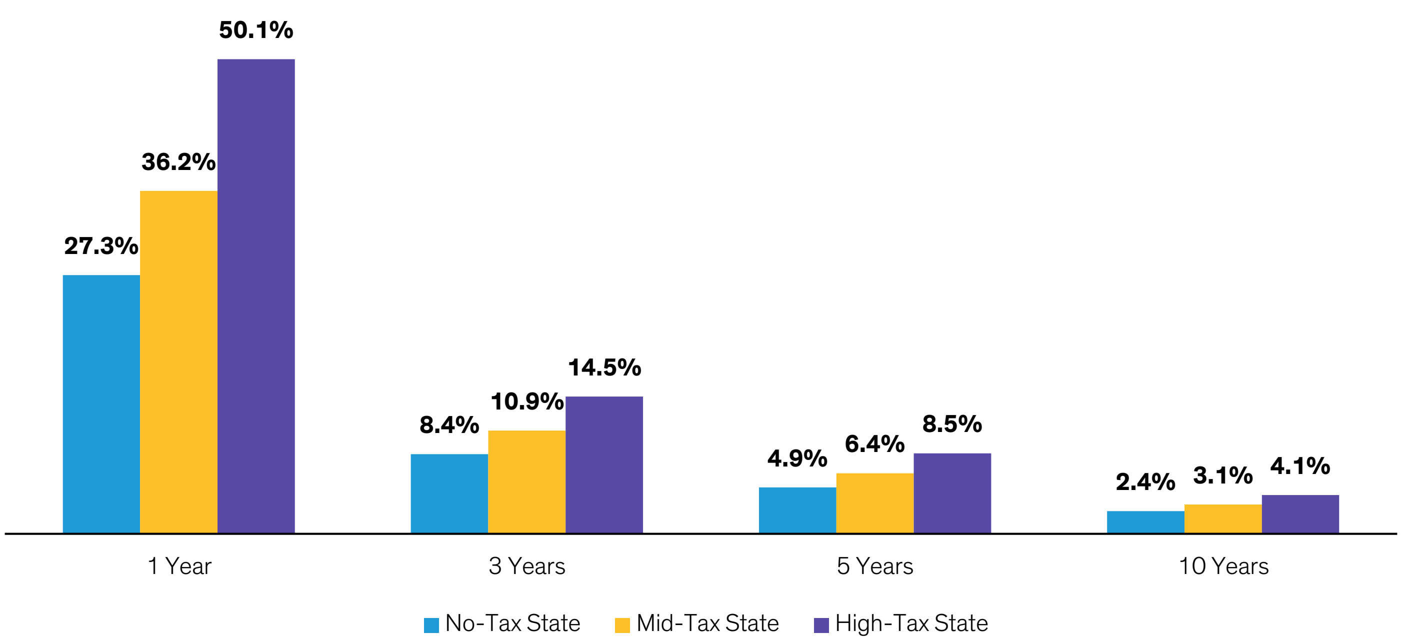
> While taxes can be a drag, they should not be the ultimate driver when considering diversification.

One of the biggest obstacles to diversifying is taxes. Why take a tax hit by selling when it's not necessary? After all, realizing a capital gain that results in taxes is a voluntary decision. You only pay the tax when you decide to sell the stock. However, selling the stock may make sense for risk management reasons, or because there are better investment opportunities available. While taxes can be a drag, they can be made up over time and should not be the ultimate driver when considering diversification. The amount of incremental return required to recover from the tax penalty will vary depending on your time horizon and tax rate (**Display 7**). For example, let's say an investor sells $1.0 million of stock with a cost basis of $100,000. In addition to paying federal tax on the gain, they must also pay any applicable state tax. If they live in a state with a mid-range tax rate, they will need to achieve an annual return over the next five years that is 6.4% higher than what they would have earned if they hadn't sold the stock. However, if they live in a high-tax state, the hurdle would be that much higher, requiring an incremental return of 8.5%. The longer their time horizon, the lower the extra return needed to overcome the initial tax drag.

While no one wants to pay taxes, there are ways to defer or eliminate them. Gifting the stock to a donor-advised fund, an exchange fund, or a charitable remainder unitrust (CRUT) are all strategies that can be effective in eliminating or deferring taxes. The choice of strategy will depend on the investor's goals and objectives. Let's explore each in turn.

**DISPLAY 7: INCREMENTAL RETURN NEEDED TO RECOUP TAXES DEPENDS ON TIME HORIZON AND TAX RATE**

Stock Value ($1.0 million) with Cost Basis of $100,000*
(Percent)




*Incremental return needed was calculated assuming a stock is sold for $1.0 million with a cost basis of $100,000 and the investor lives in a no-tax state and only pays federal taxes of 23.8%, a mid-tax state and pays a combined federal and state tax rate of 29.55%, or a high-tax state and pays a combined federal and state tax rate of 37.1%.

## Active Tax Loss Harvesting Portfolio

How can we integrate portfolio management into a diversification framework from a tax perspective? Conventional wisdom suggests that selling a concentrated stock at a large gain is necessary to reinvest in something new, which can result in a significant tax liability. While true, there is another strategy to consider—utilizing an active tax-loss harvesting strategy to blunt the tax impact of selling and realizing a gain.

With an active tax-loss harvesting strategy, you can create a portfolio of individual stocks that are designed to track the performance of an index, like the S&P 500. Compared to indexing, one of the key benefits is that the portfolio of individual stocks can be tax-traded throughout the year to harvest capital losses. This is a significant advantage that is not available through an index fund or exchange-traded fund.

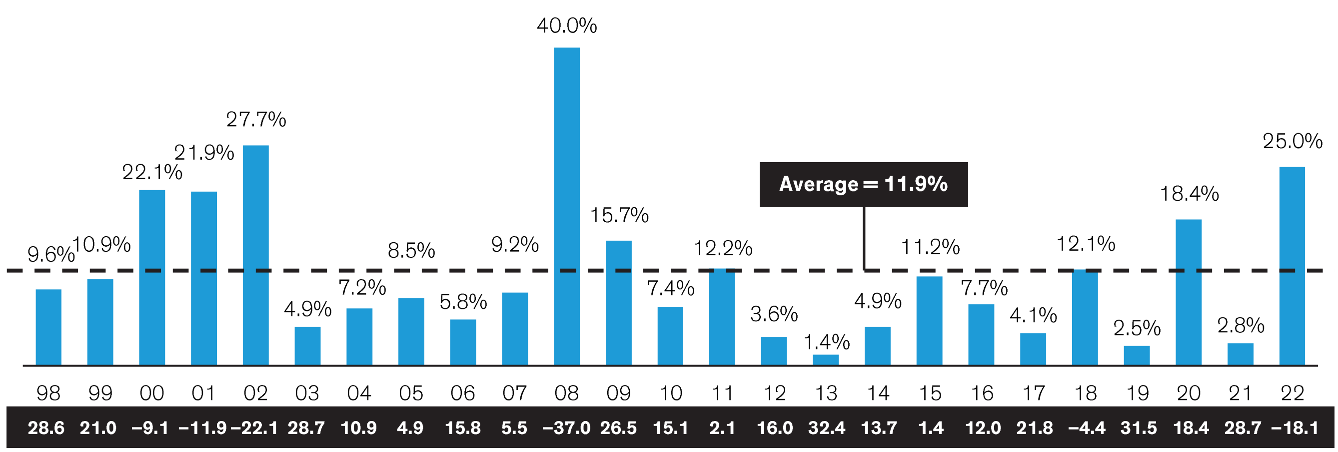
Consider the roller coaster the market endured when the pandemic first hit. An investor who put $1.0 million in the S&P 500 index at the beginning of 2020 would have earned 18.4%, growing their portfolio to $1.18 million by the end of the year. Unless they intentionally sold their shares at certain points along the way, they would have missed the opportunity to harvest losses if they waited until year-end. In contrast, if they used an active tax-loss harvesting strategy, they could have harvested 18.4% of capital losses, or $184,000, throughout the year without sacrificing return. These losses could then offset gains realized elsewhere in the portfolio—or defray some of the gains realized from selling a concentrated position to make the initial investment.

Importantly, the percentage loss that can be realized depends on the particular year (**Display 8**). On average, we have found that investors should be able to harvest around 12% in losses in the first year, assuming they invested at the beginning of the year. To do this effectively, stay mindful of wash-sale rules, replacing securities that are sold with like securities to minimize tracking error and opportunity costs.

While this strategy does not actively seek to lose money, it aims to be more efficient with the precise benefits depending on the taxpayer's time horizon, tax rate, and need to offset capital gains income.

**DISPLAY 8: Losses Harvested for First Year of Simulation**
**Simulated data**
**Year 1 results: 1998–2022**

Losses Harvested (Percent)




**Past performance is no guarantee or indication of future results.**
We evaluate the impact of strategies launched beginning in 1998 through 2022 (25 1-year periods).
Source: S&P and AB

### Charitable Gift to DAF

Philanthropic investors may be drawn to the idea of gifting appreciated stock to a donor-advised fund (DAF). Classified as a public charity, a DAF does not pay taxes. As a result, when an investor donates appreciated stock, they receive an up-front tax deduction equal to the fair market value of the gift while avoiding the embedded gains altogether. The stock can then be sold inside the DAF and the proceeds invested for growth until they're distributed according to the donor's wishes.

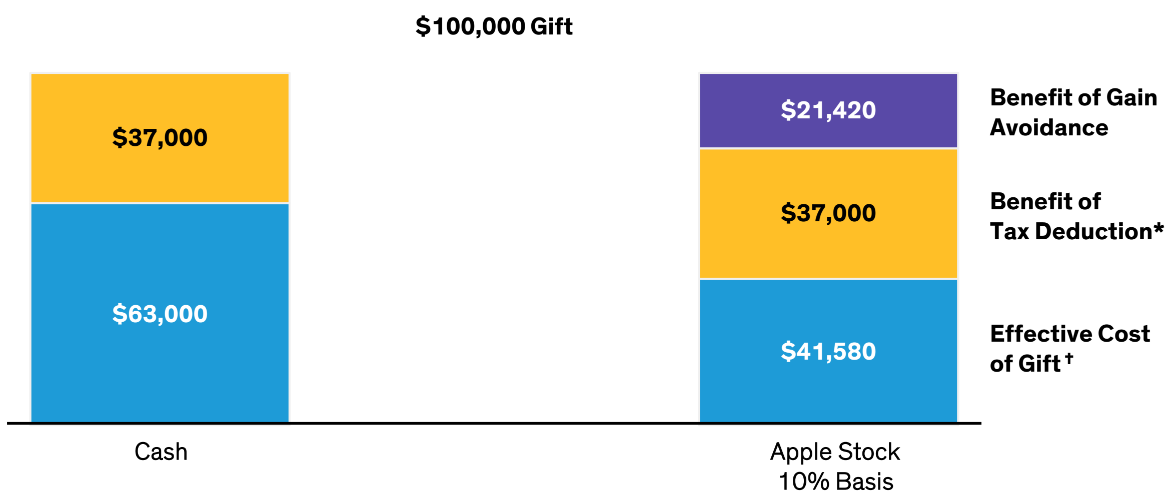
Establishing a DAF only makes sense if the investor seeks to enhance their philanthropic wealth over time. If the assets they plan to contribute will be immediately gifted to charity, a DAF may not be necessary. In this case, a direct gift of stock to the charity may be more suitable.

Donor-advised funds are also useful when the donor wants to accelerate their future charitable giving to receive a larger deduction today and offset taxes in a high-tax year due to selling other assets or earning a large bonus. Consider an investor who just realized a large gain from selling real estate and has received a significant windfall. If they typically give $20,000 per year to charity and plan to accelerate five years' worth of gifts, or $100,000, they could establish a DAF. To fund the $100,000 gift, they could use cash from the sale, or identify other highly appreciated assets on their balance sheet.

For instance, when reviewing their brokerage account, perhaps they notice that they acquired over $100,000 of Apple stock many years ago for $10,000. Whether they donate $100,000 of cash or $100,000 of Apple stock, they would receive a $100,000 tax deduction. As they were top marginal tax payers, this deduction would offset income that would otherwise be taxed at a 37% rate, saving them $37,000. The added benefit of giving $100,000 of Apple stock is that they can sidestep the $90,000 unrealized gain, which provides them with $21,420 in extra savings, assuming those gains would have been taxed at a 23.8% rate. If they still love the Apple stock, they could use the cash they were going to give to charity and buy the stock back, resetting their basis at a much higher price. (**Display 9**)

**DISPLAY 9: HOW GIVING STOCK CAN LOWER YOUR EFFECTIVE COST**

Donor in Top Tax Bracket




*Deduction limited to 60% of AGI in year of gift for cash or 30% of AGI in year of gift of appreciated publicly traded stock. Gift is to a public charity.
†Effective cost of the gift is calculated by taking the initial $100,000 gift and subtracting the benefit received from the tax deduction and any gain avoidance. In all scenarios, we assumed the tax deduction benefit would offset income otherwise taxed at 37% and that no AGI deduction limitations are reached. In the gift stock scenario, we assumed the cost basis of the Apple stock was $10,000 where the gain would otherwise have been taxed at a 23.8% rate.
Bernstein does not provide tax or legal advice. Investor should consult tax and legal professionals before making any decisions.

### Exchange Fund

Exchange Funds offer a unique approach to tax deferral that may be particularly appealing to investors looking for single-stock diversification while maintaining favorable tax treatment. An exchange fund is a privately placed investment vehicle that allows investors to contribute individual stocks in a tax-free manner in exchange for exposure to a diversified portfolio. To be eligible, investors must be both accredited investors and qualified purchasers and the fund must be willing to accept the stock in question.

Structured as limited partnerships, exchange funds typically have an 80% allocation to a core equity component and a 20% allocation to an illiquid collection of income-producing real estate. Within the equity portion, investors gain exposure to pooled collections of securities managed daily by a dedicated portfolio management team to closely track a broad benchmark, such as the S&P 500. The smaller real estate allocation is typically invested directly in multi-family residential properties, with an occasional office or retail space. Holding this illiquid real estate component allows contributions into or out of the partnership to be considered tax-free transactions under the US tax code.

> Exchange funds are ideal for investors who want to diversify their risk while kicking the tax can down the road.

By entering an exchange fund subscription, investors can contribute their concentrated stock positions and receive shares in the partnership in return. The price of these shares fluctuates daily based on the value of fund's equity and real estate holdings. The contributed shares' original cost basis is transferred to the fund in exchange for diversified units, and any embedded capital gains taxes are deferred while the asset remains in the exchange fund. This allows for immediate diversification without incurring tax costs, while still enabling clients to receive a step-up in cost basis at death.

The amount you receive back when exiting the exchange fund depends on how long you were in the fund and how it performed compared to your contributed shares. If investors exit within the first seven years, they receive the value of their exchange fund back in the form of shares from their original securities, plus additional 'filler' securities if the exchange fund outperformed the original contribution. After seven years, investors have the option to extract their value as a diversified basket of securities, typically consisting of 10-20 stocks representative of the equity benchmark tracked by the fund. Once investors receive their shares back, they can reapply their cost basis to those received shares.

While these funds offer significant benefits, investors should also be aware of their limitations. Exchange funds typically provide either daily or monthly liquidity for redemptions but enforce a 1% penalty for early withdrawals during the first three years. Some funds may also impose liquidity constraints on profits beyond how the contributed stock performs. Additionally, investors no longer receive dividends from their contributed stocks once they enter an exchange fund, although some funds allow for synthetic dividends. Lastly, the allocation to real estate may cause the fund to outperform or underperform the target equity benchmark, although most funds aim to maintain a tight tracking error.

Exchange funds offer a unique alternative for investors looking to swap their single stock exposure for a tax-managed diversified fund while deferring capital gains recognition. These funds are ideal for investors with concentrated single stock positions held at a significant gain who want to diversify their risk while kicking the tax can down the road.

### Charitable Remainder Unitrust (CRUT)

Like a DAF, a CRUT provides a tax-efficient way to diversify low-basis assets while making a charitable impact. However, the differentiator is that CRUTs also generate an income stream for the donor. To implement this strategy, a donor contributes low-basis assets to an irrevocable trust that makes annual distributions to one or more noncharitable beneficiaries—which may include the donor and the donor's spouse—for a period of years or the life of one or more individuals. At the end of the trust's term, any remaining assets are transferred to charity.

CRUTs distribute a percentage of the trust's asset value each year. The donor must select an annual payout rate of at least 5% of the trust's value, but no more than 50% of the original funding amount. The donor must also ensure that the remainder charity receives at least 10% of the trust's initial funding amount, known as the '10% remainder test.' Upon funding the trust, the donor receives an immediate charitable income tax deduction for the present value of the trust's remainder interest.[2] Additionally, federal tax law treats CRUTs as a tax-exempt entity, allowing the trust to sell appreciated assets without triggering an immediate capital gains tax. Instead, capital gains recognized on

2 Donor's deduction is based on the present value of the trust's remainder interest, calculated by taking the value of the donated property minus the present value of the annuity. Treasury Reg. 1.664-2(c)

the sale pass to the trust's noncharitable beneficiaries over time as they receive annual trust distributions, producing a tax deferral benefit.

One of the key considerations with a CRUT is to recognize that it takes time for this strategy to generate more personal wealth than simply selling the appreciated asset and paying taxes. The crossover point, or number of years it takes for the CRUT to generate more personal wealth than selling outright, will depend on many factors—with the cost basis of the contributed assets being one of the most important.

For instance, assets with a cost basis ranging from 0%–20% of their fair market value have a 92%+ chance of generating more personal wealth than selling the asset outright over 30 years (**Display 10**). However, once the asset's cost basis reaches 40% of the fair market value, the chance of achieving crossover plummets to just 42%—or even further when the basis is 60% of the fair market value. While there are many factors to consider, understanding an investor's funding sources and cost basis can help determine the suitability of this strategy.

Other crucial factors to consider when using a CRUT include (i) the donor's state of residence, (ii) the selected payout percentage, (iii) the trust term, and (iv) the asset allocation of the CRUT.

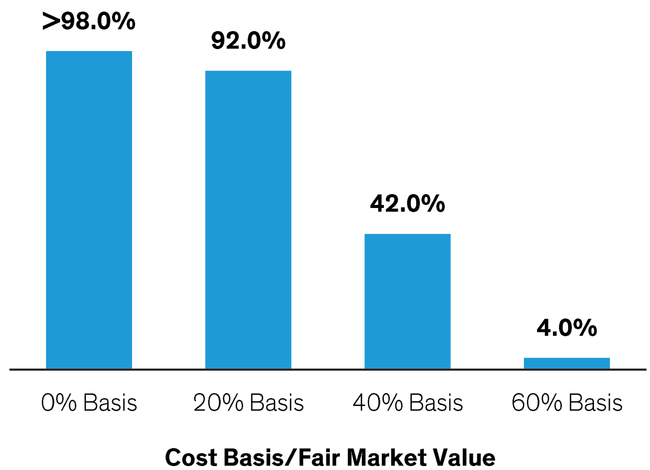
## Hedging

In addition to holding, selling, or diversifying a concentrated stock position, investors may also consider hedging as a way to protect their wealth, mitigate taxes, and diversify their portfolio. One common hedging strategy is to sell a call option using the stock they own to write the call against. When you sell a call option, you receive a premium for giving someone the option to buy the stock from you at a specific price. If the price increases above the strike price, the option is called, and you will deliver the shares you own, making it a natural way to diversify.

While selling a call may help, we believe the outcome provides an asymmetric payoff to someone who wants to implement a diversification strategy today, as you are exposed to both the downside and upside. For example, if the stock declines in value, the seller of the call will also experience the decline, which will only be slightly offset by the premium. But if the stock increases in value, they will only participate up to the strike price plus the premium received. If you are willing to hold the stock, you would want to participate in more of the upside. Therefore, covered call writing should be viewed more as an income strategy than a diversification play, which can work well if the stock moves sideways.

**DISPLAY 10: CRUTS ARE MOST EFFECTIVE WHEN CONTRIBUTED ASSETS HAVE VERY LOW BASIS**

Probability of more personal wealth in year 30*
8% CRUT vs. Outright sale




*Relative to an outright sale. Charitable deduction is based upon a joint-lifetime CRUT, assuming donors are both 65 years of age, and a Section 7520 rate of 4.0%. Assumes an asset allocation of 70% global stocks and 30% bonds for trust and personal assets. Based on Bernstein's estimates of the range of returns for the applicable capital markets over the next 30 years. Data do not represent past performance and are not a promise of actual or range of future results. See Notes on the Bernstein Wealth Forecasting System for further details. Bernstein is not a tax or legal advisor. Investors should consult these professionals as appropriate before making any decisions.

Finally, while a CRUT is an attractive strategy for diversifying low-basis assets, it's important to note that there is a charitable component to the strategy. If the donor(s) pass away prematurely, the charity could receive a larger-than-expected payout. For more in-depth research on CRUTs, see Bernstein's white paper When the Stars Align: Optimal Conditions for Charitable Remainder Trusts.

### Putting this all Together

With all these choices, which strategy should you use? The answer may be a combination. Let's consider Lenny and Leslie, a 70-year-old couple living in a state with a 6% tax rate. Leslie retired last year after a multi-decade career at a publicly traded company where she accumulated $15.0 million of XYZ stock. That position now represents 75% of their $20.0 million liquid net worth. While she knows the holding has become a significant portion of their wealth, the stock has performed well.

Plus, she's facing a steep tax bill as her average cost basis is only 30% of the stock's value. More broadly, the couple's goals include:

(i) maintaining their lifestyle of $300,000 per year;

(ii) continuing to give $50,000 per year to charity;

(iii) leaving a legacy for their children; and

(iv) minimizing their investment risk.

Our first step in helping Lenny and Leslie was to quantify their core capital—the amount needed to sustain their $350,000 lifestyle, including $50,000 of annual donations. We also calculated their surplus capital, or the amount beyond core that could be put toward further charitable or wealth transfer goals. Using our Wealth Forecasting Analysis, we determined that the pair needed $10.6 million to satisfy their core lifestyle needs, assuming a balanced allocation of 50% stocks and 50% bonds with no single stock concentration. Given that only $5 million of their current portfolio fit this profile, how could Lenny and Leslie bridge the gap while also accomplishing their other goals?

To help the couple, we proposed a combination of a DAF and selling some stock, along with an exchange fund and CRUT. Isolating the impact of each of these options allows for an "apples to apples" comparison. To do so, we assigned $1.0 million of stock to each of the following strategies:

Scenario A: Continue holding $1.0 million worth of the stock

Scenario B: Sell $1.0 million worth of stock, pay the taxes, and reinvest the after-tax proceeds

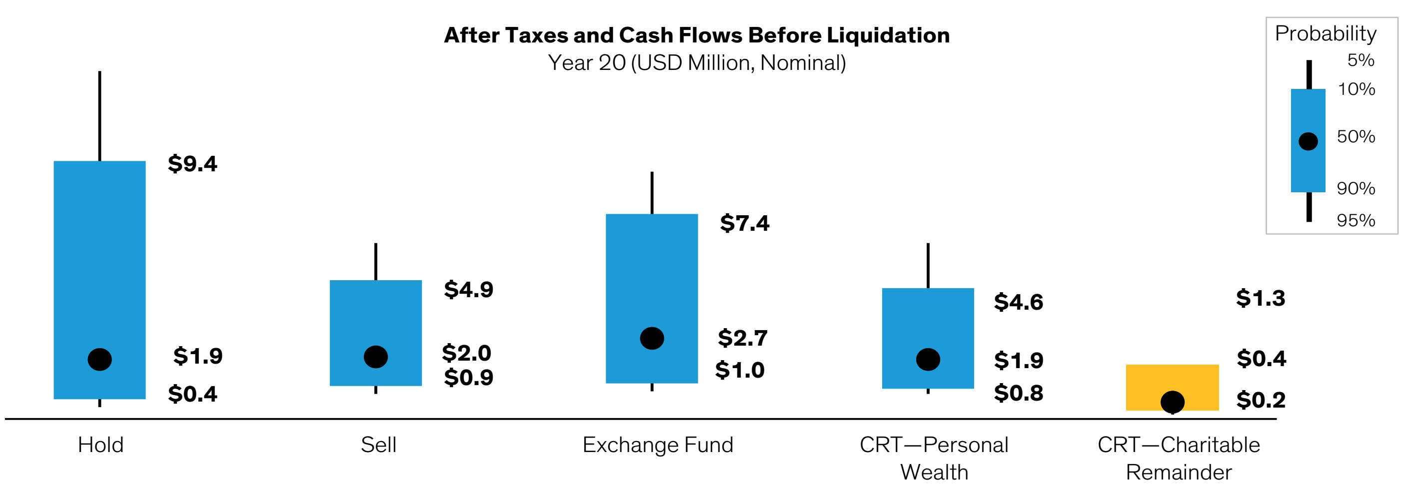
Scenario C: Contribute $1.0 million of stock to an exchange fund

Scenario D: Contribute $1.0 million of stock to a CRUT that will make a 10% payout per year

Over our 20-year analysis, each scenario has its pros and cons. Holding onto the stock delivers the most upside—but also the greatest downside if the stock performs poorly. Selling the stock provides considerable downside protection and liquidity but comes with the highest upfront tax cost and least upside potential. Contributing the stock to an exchange fund allows for instant diversification while preserving a step-up in basis at Lenny and Leslie's death. However, it only gives them access to a diversified US stock portfolio and generally provides the lowest amount of liquidity during their lifetime. What about the CRUT? It offers a unique combination of benefits, including (i) a tax deduction, (ii) a tax deferral on the gain, (iii) an annual income stream, and (iv) and (iv) a charitable legacy upon death. The main drawback is that they only gain access to 10% of the capital per year (**Display 11**).

**DISPLAY 11: EACH STRATEGY HAS ITS OWN PROS AND CONS**

Range of Portfolio Values*




*Based on AB's estimates of the range of returns for the applicable capital market over the next 20 years. Data do not represent past performance and are not a promise of actual future results or a range of future results. Asset values represent the estimated market value; if the assets were liquidated, additional capital gains or losses would be realized that are not reflected here. See Notes on the Wealth Forecasting System for further details.

## DISPLAY 12: WHERE THINGS STOOD AFTER THE PLAN

Current vs. Future Allocation of Wealth After Strategies Are Implemented

| | Current Wealth | | Future Wealth | |
|---|---|---|---|---|
| | **Amount ($)** | **Weight (%)** | **Amount ($)** | **Weight (%)** |
| XYZ Stock | $15,000,000 | 75% | $3,000,000 | 15.5% |
| Liquid Assets | 5,000,000 | 25% | 9,400,000 | 48.4% |
| DAF | - | | 1,000,000 | 5.1% |
| Exchange Fund | - | | 3,000,000 | 15.5% |
| CRUT | - | | 3,000,000 | 15.5% |
| Taxes* | | | ($600,000) | - |
| **Total** | **$20,000,000** | **100%** | **$19,400,000** | **100%** |

The Outcome

- Maintaining their lifestyle of $300,000 per year by establishing a $9.4 million core portfolio and funding a CRT that provides them a 10% interest per year
- Continue to give $50,000 per year to charity by contributing $1.0 million of XYZ stock to a DAF
- Leaving a legacy for their children by maintaining some XYZ stock and growing their asset base
- Minimizing their investment risk by reducing their XYZ exposure down to 15.5%

*Taxes were calculated on selling $5.0 million of XYZ stock with a cost basis of $1.5 million where gains are taxed at a 29.8% federal and state rate. Values assume the deduction from the DAF and CRUT is fully utilized in year 1.

Given the merits of each strategy, we recommended the following steps:

**Step 1**: Contribute $1.0 million of stock (6.7%) to a DAF. This will support ongoing donations of $50,000 per year while delivering a $1.0 million tax deduction.

**Step 2**: Contribute $3.0 million of stock (20%) to a CRUT with a 10% payout. This provides an initial up-front tax deduction of $574,000 along with an additional $300,000 of income to fund lifestyle spending.

**Step 3**: Sell $5.0 million of stock (33.3%) and reinvest the after-tax proceeds in a liquid portfolio. The $1.0 million deduction from the DAF contribution and the $574,000 deduction from the CRUT will defray a portion of the tax liability from the sale while shoring up core capital.

**Step 4**: Contribute $3.0 million of stock (20%) to an Exchange Fund. This $3 million, combined with their other assets, represents optimal exposure to a US equity portfolio.

**Step 5**: Hold the remaining $3.0 million shares (20%) and look to sell opportunistically over time or utilize for wealth transfer strategies.

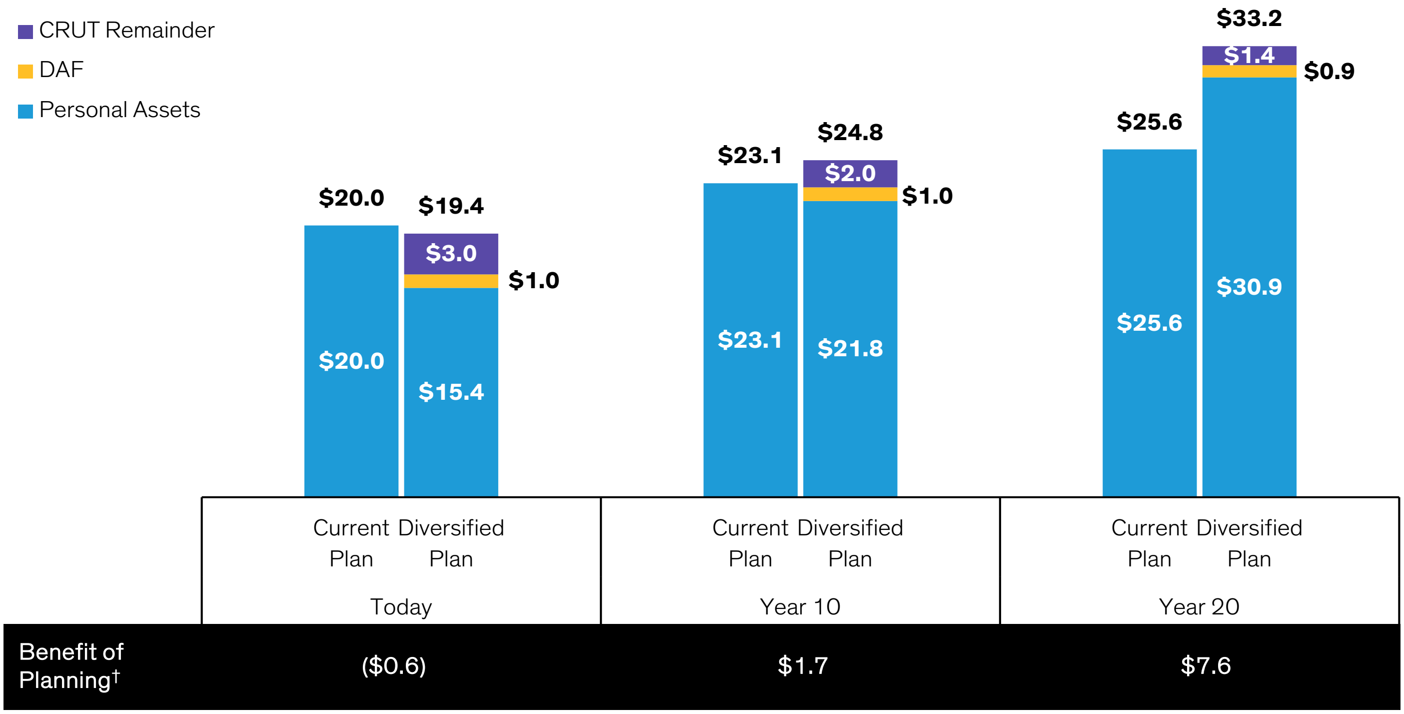
By combining these strategies, Lenny and Leslie were able to significantly reduce their single stock exposure from 75% to just 15.5% of their portfolio. They also established a charitable fund to direct their annual giving of $50,000, while netting a substantial tax deduction from the gift to the DAF and the CRUT. This deduction can be used to offset gains or carried over for up to five years. Plus, they were able to generate an income stream from the CRUT and preserve their cost basis with the exchange fund and the shares held, which will receive a step-up in cost basis upon their death (**Display 12**).

> While there are several strategies available, it's crucial to select the most appropriate one based on your circumstances.

**DISPLAY 13: HOW THE DIVERSIFIED PLAN CREATES MORE TOTAL WEALTH**

USD in Millions (Nominal)

Median Wealth over 20 Years*




*Based on AB's estimates of the range of returns for the applicable capital market over the next 20 years. Data do not represent past performance and are not a promise of actual future results or a range of future results. Asset values represent the estimated market value; if the assets were liquidated, additional capital gains or losses would be realized that are not reflected here. See Notes on the Wealth Forecasting System for further details. †Benefit of planning represents the increase in wealth of the diversified plan relative to the current plan today, in year 10, and in year 20.

Notably, implementing these strategies resulted in a meaningful increase in Lenny and Leslie's total wealth. Under their current plan, their total wealth was $25.6 million, but with the diversified plan—including the assets remaining in the DAF and the CRUT—their total wealth increased to $33.2 million over a period of 20 years (**Display 13**). Although they initially started with less due to the tax implications of selling the stock, this initial setback was quickly overcome by the deferral benefit of the CRUT, the tax avoidance achieved through the gift to the DAF, and the ability to spend from a less volatile portfolio.

### Pare Overwhelming Positions

Managing concentrated stock requires careful consideration of various factors, including risk tolerance, tax implications, and investment goals. While there are several strategies available, it's crucial to select the most appropriate one based on your individual circumstances. By finding the right combination, investors can effectively manage their concentrated stock positions and potentially increase their overall wealth. It's also important to regularly review and adjust the strategy as needed to ensure it remains aligned with changing circumstances and goals. Ultimately, with a well-planned and executed strategy, investors can ensure that their concentrated stock positions don't become too much to handle, and instead, lead to a successful and prosperous outcome.

**Notes on the Bernstein Wealth Forecasting System^SM^**

The Bernstein Wealth Forecasting System^SM^ uses a Monte Carlo model that simulates 10,000 plausible paths of return for each asset class and inflation and produces a probability distribution of outcomes. The model does not draw randomly from a set of historical returns to produce estimates for the future. Instead, the forecasts: (1) are based on the building blocks of asset returns, such as inflation, yields, yield spreads, stock earnings, and price multiples; (2) incorporate the linkages that exist among the returns of various asset classes; (3) take into account current market conditions at the beginning of the analysis; and (4) factor in a reasonable degree of randomness and unpredictability. Moreover, actual future results may not meet Bernstein's estimates of the range of market returns, as these results are subject to a variety of economic, market, and other variables. Accordingly, the analysis should not be construed as a promise of actual future results, the actual range of future results, or the actual probability that these results will be realized.



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