BERNSTEIN

IMPROVING WEALTH TRANSFER OUTCOMES WITH ALTERNATIVE INVESTMENTS

Investors pursue alternative investment strategies for both their attractive risk-adjusted returns and diversification principles. But for many wealthy families, there's a hidden bonus: Alternatives provide an excellent source of wealth transfer opportunities. By transferring an asset with high-growth potential while its value is low or discounted, a high-net-worth investor retains more applicable exclusion amount to apply to other gifts and can potentially reap additional rewards. The opportunity to add value beyond investment returns is a critical component of estate planning.

SETTING THE STAGE

The market for alternative investments[1] has grown significantly during the last 20 years. Initially, alternative investments—such as private equity, hedge funds, and real estate—drew institutional investors' focus. These large endowments, foundations, and pension plans have the sophistication level to understand more esoteric strategies and accept their associated illiquidity. More recently, high-net-worth individuals began investing in alternatives due to their attractive risk and return profiles.

As interest has increased, so too have the assets managed in these strategies. For example, private equity's net asset value has grown twice as fast as global public equities since 2002.[2] That pace is expected to continue; projections put the industry at approximately $17 trillion by 2025 from $11 trillion in 2019.[3] What's spurring the tremendous growth? Paltry expected returns from traditional fixed income and heightened volatility from lofty equity markets have prompted investors to seek new ways to generate income and growth. These potential benefits outweigh the oft-cited drawbacks—namely, higher fees, reduced transparency, and illiquidity.

Investors pursue alternative investment strategies for both their attractive risk-adjusted pretax and post-tax returns. But what many investors overlook is that alternatives are also tailor-made for estate planning in addition to their tremendous return potential. High-net-worth families can—and should—source wealth transfer opportunities from this part of their portfolio.

This paper outlines how alternatives can improve wealth transfer outcomes. First, we review why alternatives are compelling relative to other asset classes. Then we address why high-net-worth families should pair alternatives with wealth transfer.

EXECUTIVE SUMMARY

- **Alternative investments are an expanding sector of the investment landscape.**
- **A growing number of high-net-worth investors are sourcing wealth transfer from their alternative portfolios.**
- **Gifts of alternatives can provide growth and income for subsequent generations.**
- **But consideration must be given to relevant tax and securities rules.**

WHY ARE ALTS ATTRACTIVE?

Offerings within the alternative investment universe have proliferated over the last couple of decades[4] for two reasons: strong returns and diversification. Alternative investments have produced better returns than the broad stock market, with lower volatility. Yet, higher returns are only part of their draw. "Alts" also behave differently than traditional assets—most notably equities and bonds—so they tend to diversify a portfolio's long-only public market exposure. This low correlation means that when equities or bonds retrench, alternatives typically remain unaffected. Though it hasn't always been the case, an unrelated return pattern has generally unfolded over time. The long-term impact on an investor's portfolio? More predictable wealth generation and a smoother investment ride.

This long view is especially advantageous when planning for wealth and lifetime spending needs, tasks that grow significantly more difficult with unpredictable asset values. Pronounced volatility—defined by peak-to-trough losses, even if those losses are unrealized—can erode portfolio growth and investor confidence. And beyond unnerving investors, sizable drawdowns have a real financial impact, especially for those who rely on their portfolios to meet annual spending needs.

As a result, investors disenchanted with the volatility of public markets have gravitated towards alternatives—typically dipping into their equity allocations to fund them. But of late, as the bond market has treated investors to atypical bouts of volatility, fixed-income "replacements" have also grown popular. In a sense, alts act as a "hedge" against the volatility of the public equity and bond markets. Beyond managing volatility, nontraditional assets often deliver superior growth to public equities and higher yields than bonds, especially in a low-interest-rate environment. To illustrate, we used Bernstein's proprietary Alternatives Impact Analysis to compare an 80% equity/20% bond portfolio to a similar one, which included a 12% allocation to alternatives (**Display 1, next page**).

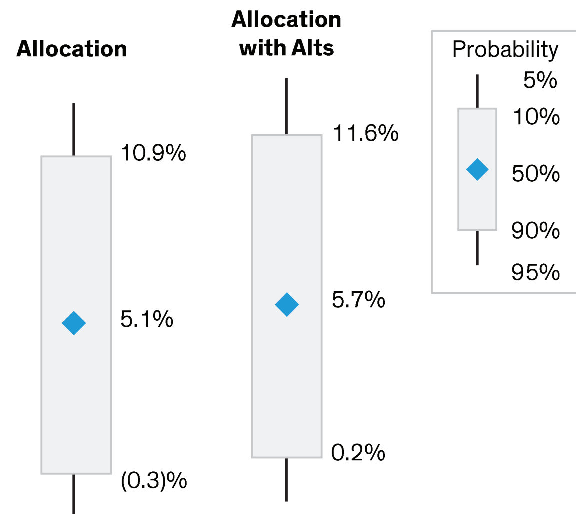
DISPLAY 1: ALTS REDUCE RISK AND INCREASE RETURNS

Projected Outcomes Based on Asset Allocation Models (10-Year Period)

	Allocation	Allocation with Alts
Median Return	5.1%	5.7%
Long-Term Volatility	15.1%	13.2%
Probability of 20% Loss	50%	47%
Tail Risk	(28)%	(29)%
Average Income	2.2%	1.8%

Range of Projected Returns

10-Year Compounded Annualized Growth Rate



Probability of 20% Loss is the probability of peak-to-trough losses which may include a multiyear period of difficult markets. Tail Risk is defined as the 99th percentile or worse outcome for an annual loss. See Assumptions and Notes on Alternatives Impact Analysis.

In this scenario, sourcing for more aggressive investments came entirely from global equities, while the alternative investments consisted of a mix of real estate and credit funds. Over 10 years, our model predicts a growth-oriented allocation to alternatives profoundly impacted the portfolio—boosting the median return from 5.1% to 5.7% and reducing the long-term volatility from 15.1% to 13.2%—although the portfolio with alts generated slightly lower average income.[5]

THE OTHER SIDE OF THE COIN

And yet, adding alts to a portfolio is not without drawbacks. Many alternative investments—such as private equity, venture capital, and real estate—are illiquid and do not generate steady cash flow. Instead, they deliver profits upon exiting a position. Further, these long-dated strategies tend to have "lock-ups" that prohibit investors from selling or redeeming for a specified period, usually multiyear horizons. And they are typically subject to capital commitments that span several years. In certain circumstances, alts may drag down portfolio performance since—like any other investment—they are not immune from losses and may underperform other asset classes. This underperformance can be especially frustrating if private market portfolios lose money while public markets deliver gains.

Although alts tend to be less volatile than traditional equities, that is not always the case. For example, private market investments focused on the hospitality and travel industries experienced significant losses during the COVID-19 pandemic.[6] Accordingly, investors considering alternatives solely to minimize volatility may be in for an unpleasant surprise.

Alternative investments often generate significant income tax relative to their traditional counterparts, detracting from overall returns. For example, hedge funds that sell a stock short are subject to ordinary income tax rates (short-term capital gain), regardless of the holding period. This tax drag may be acceptable in some cases, depending on the attractiveness of the investment's pretax return. For that reason, investors should compare the after-tax performance to that of other assets when considering an alternative investment. Tax impact represents the first input when calculating an investment's "hurdle rate"—or the lowest acceptable return given the tax cost combined with the investment's fees, transparency, and liquidity profile.

Alts typically charge higher fees than most traditional investments. For example, some hedge funds assess fees based on a "2 and 20" structure—a 2% management fee and a 20% performance fee.[7] By comparison, public equity portfolio fees tend to fall below 2%. To that end, the amount charged to the investor creates another "hurdle." As with after-tax returns, an investor must weigh fees when reviewing potential investment opportunities.

Structure also merits consideration. Partnerships or limited liability companies taxed as partnerships tend to be most common.[8] Owning a minority interest in a partnership or limited liability company means that the investor has little control over the entity and its activities. Lack of transparency magnifies this limited control. Results, holdings, attribution, valuation, and commentary—while available monthly or quarterly—are usually delayed by weeks or longer. Moreover, these entities sometimes restrict transfers of interests to family members or others.

Securities law restrictions, as discussed below, are also a consideration. The restrictions, along with lack of control, can be unwelcome features.

In many cases, alternatives' growth and diversification profile outweighs these concerns, especially for individuals considering wealth transfer options (**Display 2**). Why? Because the potentially negative attributes can create compelling opportunities for wealth transfer strategies.

designed for growth suits a younger beneficiary with a sufficiently long investment horizon to recover from market drawdowns. This shift in mindset opens the entire universe of alternative investments to older generations (grantors).

Can illiquidity be attractive? Parents and grandparents who wish to preserve and protect assets from spending may find this feature appealing since owners cannot readily sell illiquid assets. In this case, embracing illiquidity imposes spending discipline on future generations.

DISPLAY 2: TWO SIDES OF ALTERNATIVE INVESTMENTS

Advantages

- Superior risk/return profile
- Differentiated return stream leads to:
  - Low correlation with public securities
  - Reduced portfolio volatility
- Higher growth/yield than public equities/bonds
- Access to niche investments and inefficient markets

Drawbacks

- Can be Illiquid
- Can be tax-inefficient
- Uneven return of investment and cash flow
- Higher fees
- Structure affords little investor control
- Diminished transparency
- Potential transfer or securities law restrictions

EXPAND WEALTH TRANSFER USING ALTERNATIVES

The high growth potential of alternatives relative to other assets makes them natural candidates for wealth transfer. Moving assets while values are low or discounted ensures future growth occurs off the investor's balance sheet to benefit designated beneficiaries. Early-stage alternatives and alternatives depressed due to market conditions or long lock-up periods often have a low value relative to expected return, which means a high-net-worth investor retains more applicable exclusion amount to apply to other gifts.[9]

There are other less-obvious benefits, too. For example, specific alternatives—such as hedge funds—generate considerable income tax. Transferring an asset with a high ongoing tax liability may seem unwise. However, in moving the hedge fund or a similar high income-tax generating gift to an irrevocable grantor trust, the grantor retains the tax liability. Payment of the income tax will allow the trust to grow income-tax free. Better yet, that tax settlement doesn't use the grantor's applicable exclusion amount.[10] This way, pairing a gift in tax-inefficient alternatives with an irrevocable grantor trust promotes highly efficient wealth transfer.

Investors concerned about the income tax associated with alternatives might prefer investing through a private placement life insurance policy (see discussion below). The life insurance "wrapper" blocks the immediate taxation of the investments held within the policy. Following the insured's death, the benefit passes to the beneficiaries (or to a trust for their use) free of income tax. Note that the ability to gift on a discounted basis is limited since these policies must be funded with cash.

However, the overall income tax benefit can be meaningful. Other aspects of alternatives that tend to give investors pause—volatility and illiquidity—are not problematic for younger beneficiaries. An aggressive allocation

Alternatives' partnership and LLC structure also offer wealth transfer opportunities. Moving minority interests to trusts discounts the interests' value due to lack of control and marketability, as well as illiquidity. Similar discounts apply to the interests that remain on an investor's balance sheet following his or her death. As demonstrated in the case study below, a family can amplify these discounts by transferring the interests to a family limited liability company (LLC) or family partnership and then giving interests in the family LLC to a grantor trust. The importance? Interests pass to heirs at up to 40% less than liquidation value.[11]

WEALTH TRANSFER IN ACTION

Let's walk through an example of a typical wealth transfer strategy.

Anna and Allen Goodwin wanted to transfer wealth to their family. The Goodwins had already established an irrevocable grantor trust to benefit their children (the "children's trust") and funded the trust with $3.5 million in private equity interests. The children's trust has been a qualified purchaser since its inception.[12] But they wanted to transfer additional surplus assets that they didn't need to secure their lifestyle.

Initially, Anna and Allen intended to limit additional wealth transfer to giving the children's trust $8 million in publicly traded securities, which would exhaust their remaining applicable exclusion amount and cover additional capital calls. However, the Goodwins owned additional securities. What if they gave the publicly traded securities and sold additional assets to the children's trust? The sale would not bear income tax because the children's trust is a grantor trust.[13] In addition, a sale would transfer additional wealth without using any additional applicable exclusion amount.

Bernstein worked with their estate planning counsel to develop the following three-step plan:

Step 1—Gift: Give $8 million of publicly traded securities to their children's trust.

Step 2—Structure: Form an LLC taxed as a partnership with the Goodwins and the children's trust as the partners.

- Allen and Anna would contribute additional securities to the LLC, and the children's trust would contribute securities and its private equity interests.
- The Goodwins would own a 0.5% managing member interest and a 67.5% non-managing interest.
- The children's trust would own a 0.5% managing member interest and a 31.5% non-managing membership interest.

Step 3—Sale: Allen and Anna sell their 67.5% non-managing member interest to the children's trust in exchange for a 30-year promissory note. The sale includes a 30% discount for lack of marketability and control resulting in a $14 million sale price.

- Interest-only payments of $189,000 would come due in the first 10 years of the note period (based on a 1.35% long-term AFR[14]) followed by interest plus principal payments of $567,787 over the next 10 years.
- They would repay the remaining note balance of $9,946,981 in year 20.
- After 20 years, they would terminate the grantor status for the children's trust.

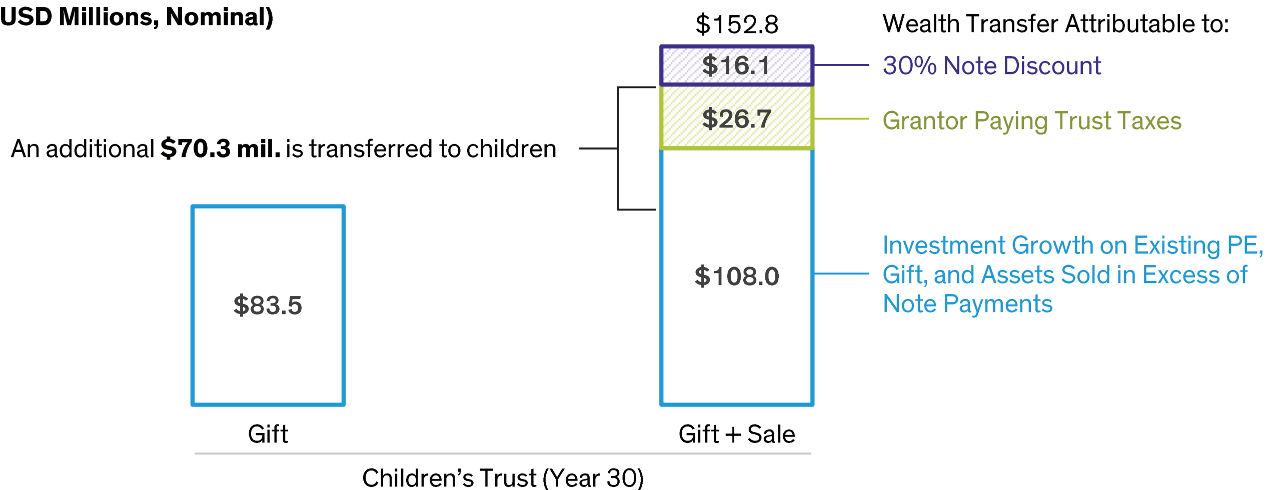
Bernstein analyzed the potential impact over a 30-year time horizon of a gift of $8 million only, compared to a gift of $8 million plus the sale described above. The analysis showed that, in the median case, by engaging in the sale plus giving $8 million (their remaining exclusion) to the trust, the Goodwins transfer an additional $70.3 million[15] (as compared to a gift without a sale), ***without using any additional applicable exclusion amount*** (**Display 3**). These compelling results stem from the expected growth of the private equity, the Godwin's payment of income taxes for 20 years, and the discounted value of the LLC interests sold to the trust.[16] After seeing the potential outcome, the couple elected to proceed with both the gift and sale.

WHAT IS PPLI?

Eligible individuals can purchase a private placement life insurance policy (PPLI) to shelter their high-tax-generating alternative investments from income taxes. The benefit? For those investors with a time horizon of more than five years, investing in tax-inefficient alternative investments via a PPLI may provide superior after-tax returns when compared to investing via a taxable account because assets owned within a life insurance policy are not subject to income tax. While retirement vehicles are preferred for tax-inefficient investments, their capacity has limits. PPLI can serve as an effective way to shield additional tax-inefficient investments. In certain circumstances, investors can achieve wealth transfer benefits and estate tax savings by owning PPLI through irrevocable trusts.

Which types of strategies are best suited in this structure? Hedge funds, investments in private lending, or any strategy that generates ordinary income and short-term capital gains are attractive candidates. However, each investor's situation is unique and requires custom analysis by astute tax and wealth planning professionals.

DISPLAY 3: PROJECTED WEALTH:* CHILDREN'S TRUST



*Based on AB's estimates of the range of returns for the applicable capital markets over the periods analyzed.
Past performance does not guarantee future results. Values are based on the estimated market value; if the assets were liquidated, additional capital gains or losses would be realized that are not reflected here. See Assumptions and Notes on the Wealth Forecasting System.

PRACTICAL CHALLENGES

While the benefits of using alts in wealth transfer abound, so do the challenges. For example, most alts don't undertake daily valuations—investors need to wait for monthly or quarterly pricing. Further, alternatives commonly limit when owners can assign interests. This combination of valuation and assignment constraints can create challenges for specific wealth transfer strategies—such as grantor retained annuity trusts (GRATs)—which require precision for the payment of annuities. Accordingly, it is critical to ensure transfer strategies can accommodate valuation and assignment limitations.

Capital calls may also come into play. Private equity, for example, often calls for investors' capital over five-year periods. When transferring private equity to a trust, investors must simultaneously provide enough liquidity to satisfy these commitments. An investor who makes a gift of private equity interests to an irrevocable grantor trust can make subsequent gifts as capital is due.[21] Further, the grantor could lend assets to the irrevocable grantor trust to satisfy capital calls.

GRATS AND ALTERNATIVES DON'T ALWAYS MIX

While alts and wealth transfer may seem like an ideal pairing, it's not always a perfect match. Consider Mary, who transferred a modest number of alternative investments to a GRAT[17] whose annual annuity payments came due mid-month. The challenge? The alts' valuation occurred on the first of the month but was not typically published until the 15th business day. This reporting and remitting mismatch made it impossible to "true-up" the annuity payment until 15 days after the annuity payment was due. The required true-up was not insurmountable because annuity payments made within 105 days of the due date are permissible, but it made cash flow planning more difficult for Mary.[18]

What's more, the GRAT was successful, which meant it had to distribute part of the investment at the term's end. But since the beneficiary was not a qualified purchaser,[19] she could not own the investment.[20] And because the GRAT's "win" fell below the investment minimum, the sponsoring manager could not hold the assets either. As a result, the investment had to be liquidated, which posed further challenges. Most notably, liquidations:

- **required 90 days advance notice,**
- **were unavailable until 45 days after the liquidation date, and**
- **were subject to a nine-month cash holdback.**

In the end, the pairing proved problematic, and the investor had to investigate a more optimal strategy.

However, an investor who wishes to use a GRAT must fund it with sufficient liquidity to meet capital calls in advance. That additional capital will add to the calculation base of the GRAT annuity payment.[22] As such, GRATs are suboptimal for transferring private equity investments.

However, certain private equity strategies may prove ideal for grantors interested in gifting interests in a private fund to take advantage of the discount and move the potentially appreciating asset off their balance sheet. Strategies like secondary funds[23] neither burden the beneficiary with capital calls nor require the grantor to make those calls. Secondary funds generally call capital faster than traditional private equity funds. Likewise, funds that invest the total commitment at inception—like hedge funds or alternative credit—may appeal to such an investor. Their more frequent liquidity windows, however, may decrease discounts available for lack of liquidity. As such, an investor must carefully consider cash flow needs versus discounting goals.

Transfer strategies should also factor in restrictions. Not all funds permit transfers, while others allow them with prior consent and/or to a restricted class (e.g., family members or trusts for family members' benefit). Before dedicating the alternative investment to a wealth transfer strategy, it is critical to determine whether a fund allows transfers and under what circumstances.

For example, suppose a high-net-worth investor transfers alternatives to a trust by gift or bequest. In that case, the trust will inherit the grantor's qualified purchaser status.[24] On the other hand, if the investor sells alternatives to a defective grantor trust, the trust will need to qualify as a qualified purchaser independent of the grantor before owning the investments. The same is true if the trustee decides to invest in additional alternatives.

Before accepting an alternative or allocating additional trust assets to alternatives, the trustee must determine whether the investment is appropriate in light of the beneficiaries' needs.[25] Absent a specific waiver or modification in the trust instrument, the prudent investor rule will govern whether an alternative investment is appropriate for a trust and—if so—its proper investment size. While the growth potential of alternatives may seem attractive for beneficiaries with a long time horizon, investing an entire trust corpus in an alternatives portfolio may not be appropriate. Accordingly, the size of the investment relative to the whole portfolio matters.

COMPLEX, BUT WORTH IT

The popularity of alternative investments will undoubtedly expand their use as wealth transfer tools. And that makes sense since gifts of alternatives can provide growth and income for subsequent generations. Still, wealth plans must manage these gifts carefully to comply with relevant tax and securities rules. Working with an estate, tax, and investment professional who is well versed in planning with alternatives is critical to maximize the benefits for high-net-worth families.

ARE YOU AN ACCREDITED INVESTOR OR QUALIFIED PURCHASER?

Accredited investor and qualified purchaser rules drive many of the limitations for transferring alternative investments. Under the Securities Act of 1933,[26] a company that offers securities must register with the Securities and Exchange Commission (SEC). However, there is an exemption if the company only sells to accredited investors.[27] An individual is considered an accredited investor if (1) the individual's net worth, or joint net worth with the individual's spouse, exceeds $1,000,000, or (2) for each of the two most recent years, such person's income exceeds $200,000 or joint income with the individual's spouse exceeds $300,000.[28]

If a fund exceeds 100 investors, it will need to register with the SEC, even if all the investors are accredited investors, unless an exception applies. The Investment Company Act of 1940 provides that privately held investment companies are excluded from registration if (1) the company does not make or propose a public offering, and (2) the outstanding securities are owned exclusively by "qualified purchasers."[29] A qualified purchaser is an individual with no less than $5 million in investments.[30] What if a high-net-worth investor wants to transfer her interest to a trust for the benefit of her descendants? In that event, the transfer's nature determines whether the recipient trust must also satisfy the qualified purchaser requirements. A trust must demonstrate one of the following to be deemed a qualified purchaser:[31]

1. **$25 million in assets;**
2. **$5 million in assets, at least two beneficiaries, and all beneficiaries must share an appropriate familial relationship with the grantor; or**
3. **The trustee and grantor are both qualified purchasers.**

Endnotes:

1 For purposes of this article, "alternative investments" are defined as hedge funds, private equity, venture capital, real estate equity and debt, private corporate lending, and special situations opportunistic investing.

2 McKinsey & Company, "Private markets come of age: Global Private Markets Review 2019," McKinsey Global Private Markets Review, 2019.

3 Preqin, "The Future of Alternatives," 2020.

4 Id.

5 **(a) Purpose and Description of Alternatives Impact Analysis Tool**
AB's Alternatives Impact Analysis Tool (AIA) is designed to assist investors in making their long-term investments decisions as to their allocation of investments amongcategories of financial assets. Our planning tool consists of a five-step process: (1) Client-Profile Input: the client's asset allocation, risk-tolerance level, liquidity needs, goals and other factors; (2) Client Scenarios: a range of expected returns over a 1 to 20-year period for a series of portfolios with different asset allocations assuming the oversight of investment managers with varying levels of skill; (3) The Capital Markets Engine (CME): our proprietary model that uses our research and historical data to create a vast range of hypothetical market returns (beta), which takes into account the linkages within and among the capital markets, as well as their unpredictability; (4) The multi-asset risk model: we use risk analytics from Axioma to forecast risks of a very broad universe of public securities such as stocks, bonds, derivatives including futures, forwards, options, swaps, etc. We then aggregate up security level risk forecasts to product and portfolio level, and finally (5) A Probability Distribution of Outcomes: based on the assets invested pursuant to the stated asset allocation, 90% of the estimated ranges of probable returns and asset values the client could experience are represented within the range established by the 5th and 95th percentiles on "box-and-whiskers" graphs. However, outcomes outside this range are expected to occur 10% of the time; thus, the range does not guarantee results or establish the boundaries for all outcomes. Estimated market returns on bonds are derived taking into account yield and other criteria. An important assumption is that stocks will, over time, outperform long bonds by a reasonable amount, although this is in no way a certainty. Moreover, actual future results may not meet AB'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. The information provided here is not intended for public use or distribution beyond our private meeting. Of course, no investment strategy or allocation can eliminate risk or guarantee returns.

AIA is a multi-asset analytics platform. We run portfolio scenarios that draw from a universe of over 100,000 global securities and consider 10,000 different potential outcomes. AIA is designed to illustrate trade-offs among passive management and active strategies offered by AllianceBernstein, with investment selection dictated by which offerings best match the client's asset allocation and risk tolerance parameters. The universe of investment products that AIA considers includes those products proprietary to AB as well as certain passive investment products covering major market indices. Other investment products not considered within the AIA platform may have characteristics similar or superior to those being analyzed.

Our AIA system is flexible, broad and transparent. With asset allocation parameters as our guide, we calculate sector, geography, market capitalization and other relevant weights across all major asset classes. We analyze both active and passive investments at the underlying security level. We use a risk model provided by Axioma to perform factor and security-based risk decomposition and then generate risk estimates and quantify the impact of manager skill on actively managed products. To round out our analysis, we include metrics on turnover, liquidity and relevant benchmarks to illustrate how the modeled asset allocation aligns with the client's needs and goals.

Return projections are created by separating out alpha from beta. Beta projections are derived by mapping portfolio security holdings into appropriate asset classes in our CME model and applying the CME projections. We project alpha using AB's estimates of the information ratio (IR) of above-average and below-average managers as a proxy for their skills, and using active risk (tracking error) calculated from the Axioma risk model. IR and tracking error are then used to back out the projected alpha. In this manner, we are not attempting to directly forecast manager's excess return, but are still able to quantify the potential impact of active management on forecasted portfolio returns.

Long-term volatility is the standard deviation of annual returns over the indicated investment horizon. Percentage loss is a projected measure of the highest value to the lowest value in an investment portfolio. Because the AIA 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 include an upward adjustment intended to account for the incidence of peak-to-trough losses that do not last an exact number of years. Tail risk is a measure of highly unlikely, yet possible, negative outcomes and represents the average potential annual losses among the 1% worst outcomes. Tail risk may differ from the 10-year probability of percentage losses which may include a multiyear period of difficult markets. We calculate these measures along with the projected returns using 10,000 projected outcomes from AB's Capital Markets Engine.

(b) Allocations to Alternative Investments
Any recommendations regarding asset allocations that include Bernstein alternative investments are based on a number of important criteria, including but not limited to consideration of the client's stated financial circumstances and risk profile, the client's investment experience and history, and an analysis of the goals and characteristics of the recommended alternative investments. Recommendations to alternative investments are only available to those clients who are Qualified Purchasers and/or Accredited Investors, as applicable, as those terms are defined under the US securities laws. To determine a client's risk profile, we evaluate the risk/reward ratio of the client's chosen return seeking/risk mitigating allocation before any consideration of alternative investments. We also assess a client's investment experience and history to determine whether or not their investing background and sophistication are commensurate with the complexity and risks associated with a particular alternative investment. Our recommendations for a client's allocation to alternative investments are limited to a level that we believe is suitable for the client's risk profile and experience, as described by the client. Additionally, we closely examine our assumptions regarding the behavior and characteristics of the particular alternative investments we recommend to a client in terms of risk, premium goals, the capital markets and correlation with other products—and only recommend alternative investments that we believe are consistent with the client's investment goals.

Recommendations to alternative investments should not be construed as a promise of actual future results, investments or as legal or tax advice. A description of an alternative investment's underlying assumptions is available on request. The characteristics of alternatives vary widely. Our recommendations are intended only to apply to the specific Bernstein alternatives under consideration. These recommendations are intended to provide guidance only and do not imply that other allocations would not be suitable.

An offer to invest in shares or limited partnership interests of any Bernstein alternative investment is made only pursuant to the offering documents for the specific investment. The offering documents may include a Confidential Memorandum or Prospectus, a Limited Partnership Agreement, current financial statements of the fund and a Subscription Application. All offering documents should be read in their entirety.

The management fees and other expenses, including performance incentive fees (if applicable), that clients pay in connection with their alternative investments are described in the offering documents for the specific investments.

Prospective investors should take into account the following considerations in making an investment decision regarding any Bernstein alternative investment. This is not intended to be a complete description of relevant factors and a comprehensive discussion of risk factors and conflicts of interests can be found in the offering documents related to specific product offering. Please read all offering documents carefully before deciding to invest.

Investments in alternative strategies are speculative and involve a high degree of risk. Alternative investments may exhibit high volatility and investors may lose all or substantially all of their investment. Investments in illiquid assets and foreign markets and the use of short sales, options, leverage, futures, swaps, and other derivative instruments may create special risks and substantially increase the impact and likelihood of adverse price movements. Interests in alternative investment funds are subject to limitations on transferability, are illiquid and no secondary market for interests typically exists or is likely to develop. Alternative investment funds are typically not registered with securities regulators and are therefore generally subject to little or no regulatory oversight. Performance compensation may create an incentive to make riskier or more speculative investments. Alternative investment funds typically charge higher fees than many other types of investments, which can offset trading profits, if any. There can be no assurance that any alternative investment fund will achieve its investment objectives.

(c) Rebalancing
The AIA model assumes projected risk and returns are calculated assuming annual rebalancing to target allocations. The model ignores the rebalancing implications of liquidity constraints or tax consequences. Actual portfolios would be rebalanced continuously using cash flows in and out of the portfolio, gains generated from turnover, and income generated from dividends and interest.

(d) Fees and Expenses
All projected returns in AIA are presented after subtracting investment management fees and incentive fees for each product in the portfolio.

(e) Tax Implication
The AIA analysis does not account for taxes.

Before making any asset allocation decisions, an investor should review with his/her tax advisor the tax liabilities incurred by the different investment alternatives presented herein including any capital gains that would be incurred as a result of liquidating all or part of his/her portfolio, retirement-plan distributions, investments in municipal or taxable bonds, etc. AB does not provide tax, legal, or accounting advice. In considering this material, you should discuss your individual circumstances with professionals in those areas before making any decisions.

(f) Technical Assumptions
AB's Alternatives Impact Analysis is based on a number of technical assumptions regarding the future behavior of financial markets. AB's Capital Markets Engine is the module responsible for creating simulations of returns in the capital markets. These simulations are based on inputs that summarize the current condition of the capital markets as of June 30, 2020. Therefore, the first 12-month period of simulated returns represents the period from June 30, 2020 through June 30, 2021, and not necessarily the calendar year of 2020. A description of these technical assumptions is available on request.

6 Investec.com, "Why high net worth individuals are looking to alternative investments post-Covid," Ellen Redmond, September 2, 2020.

7 See David S. Miller and Jean Bertrand, "Federal Income Tax Treatment of Hedge Funds, Their Investors, and Their Managers," Vol. 65, No. 2, Tax Lawyer 311 (2012).

8 Ownership of alts through an individual retirement account or qualified retirement plan will postpone the imposition of income tax, but if the investment is structured as a partnership or other pass-through entity for income tax purposes, it may generate currently taxable unrelated business taxable income. See § 512 and § 514. Sections referenced herein are to the Internal Revenue Code of 1986, as amended, and the regulations thereunder, unless otherwise specified.

9 The applicable exclusion amount is the amount that a person can pass to any person or entity without paying US gift or estate tax. The applicable exclusion amount in 2021 is $11.7 million per person. See § 2010.

10 Revenue Ruling 2004-64.

11 See § 2010. The valuation of family entities, including applicable discounts, has been the subject of extensive Tax Court litigation. For example, in Grieve v. Commissioner (T.C. Memo 2020-28) published March 2, 2020, the Tax Court rejected IRS methodology limiting applicable discounts for non-voting membership interests. The valuation of business entities and determination of applicable discounts is beyond the scope of this paper. See Business Valuations for Estate and Gift Tax Purposes, AICPA (2015) for a comprehensive review of valuation approaches.

12 Refer to "Are you an accredited investor or qualified purchaser" discussion.

13 § 671-678.

14 See § 1274(d). The AFR is the applicable federal rate, which is the minimum rate family members must charge for intra-family loans so that the IRS does not recharacterize the loans as gifts.

15 In the median case, the Goodwins transfer $82.5 million from the gift alone plus an additional $70.3 million from the sale for a total of $152.8 million. The Children's Trust has $3.5 million in private equity interests at the start of the analysis. The interests have a commitment of $10 million, of which $3.5 million had been called prior to the start of the analysis. The remaining $6.5 million commitment is assumed to be called evenly over the next three years. Beginning in 2027, the commitment will distribute evenly over three years with a two times multiple, assumed to be taxable as capital gain with half basis.

16 **(a) Purpose and Description of Wealth Forecasting System**
AB's Wealth Forecasting Analysis is designed to assist investors in making their long-term investment decisions as to their allocation of investments among categories of financial assets. Our planning tool consists of a four-step process: (1) Client-Profile Input: the client's asset allocation, income, expenses, cash withdrawals, tax rate, risk-tolerance level, goals and other factors; (2) Client Scenarios: in effect, questions the client would like our guidance on, which may touch on issues such as when to retire, what his/her cash-flow stream is likely to be, whether his/her portfolio can beat inflation long-term, and how different asset allocations might impact his/her long-term security; (3) The Capital-Markets Engine: our proprietary model that uses our research and historical data to create a vast range of hypothetical market returns, which takes into account the linkages within and among the capital markets, as well as their unpredictability; and finally (4) A Probability Distribution of Outcomes: based on the assets invested pursuant to the stated asset allocation, 90% of the estimated ranges of probable returns and asset values the client could experience are represented within the range established by the 5th and 95th percentiles on "box-and-whiskers" graphs. However, outcomes outside this range are expected to occur 10% of the time; thus, the range does not guarantee results or establish the boundaries for all outcomes. Estimated market returns on bonds are derived taking into account yield and other criteria. An important assumption is that stocks will, over time, outperform long bonds by a reasonable amount, although this is in no way a certainty. Moreover, actual future results may not meet AB'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. The information provided here is not intended for public use or distribution beyond our private meeting. Of course, no investment strategy or allocation can eliminate risk or guarantee returns.

(b) Rebalancing
Another important planning assumption is how the asset allocation varies over time. We attempt to model how the portfolio would actually be managed. Cash flows and cash generated from portfolio turnover are used to maintain the selected asset allocation between cash, bonds, stocks, REITs and hedge funds over the period of the analysis. Where this is not sufficient, an optimization program is run to trade off the mismatch between the actual allocation and targets against the cost of trading to rebalance. In general, the portfolio allocation will be maintained reasonably close to its target. In addition, in later years, there may be contention between the total relationship's allocation and those of the separate portfolios. For example, suppose an investor (in the top marginal federal tax bracket) begins with an asset mix consisting entirely of municipal bonds in his/her personal portfolio and entirely of stocks in his/her retirement portfolio. If personal assets are spent, the mix between stocks and bonds will be pulled away from targets. We put primary weight on maintaining the overall allocation near target, which may result in an allocation to taxable bonds in the retirement portfolio as the personal assets decrease in value relative to the retirement portfolio's value.

(c) Expenses and Spending Plans (Withdrawals)
All results are generally shown after applicable taxes and after anticipated withdrawals and/or additions, unless otherwise noted. Liquidations may result in realized

Asset Class	Modeled as:	Annual Turnover Rate
Municipal Cash	Municipal money-market securities	100%
Intermediate-Term In-State Municipals	AA-rated in-state municipal bonds of 7-year maturity	30%
US Diversified	S&P 500 Index	15%
US Value	S&P/Barra Value Index	15%
US Growth	S&P/Barra Growth Index	15%
US Low Vol Equity	MSCI US Minimum Volatility Index	15%
Developed International	MSCI EAFE Unhedged	15%
Emerging Markets	MSCI Emerging Markets Index	20%
US SMID	Russell 2500	15%
High-Risk Intl	Country Fund	15%

gains orlosses, which will have capital-gains tax implications.

(d) Modeled Asset Classes
The following assets or indexes were used in this analysis to represent the various model classes:
(e) Volatility
Volatility is a measure of dispersion of expected returns around the average. The greater the volatility, the more likely it is that returns in any one period will be substantially above or below the expected result. The volatility for each asset class used in this analysis is listed on the Capital-Market Projections page at the end of these Notes. In general, two thirds of the returns will be within one standard deviation. For example, assuming that stocks are expected to return 8.0% on a compounded basis and the volatility of returns on stocks is 17.0%, in any one year it is likely that two thirds of the projected returns will be between (8.9)% and 28.8%. With intermediate government bonds, if the expected compound return is assumed to be 5.0% and the volatility is assumed to be 6.0%, two thirds of the outcomes will typically be between (1.1)% and 11.5%. AB's forecast of volatility is based on historical data and incorporates AB's judgment that the volatility of fixed income assets is different for different time periods.

(f) Technical Assumptions

AB's Wealth Forecasting System is based on a number of technical assumptions regarding the future behavior of financial markets. AB's Capital Markets Engine is the module responsible for creating simulations of returns in the capital markets. These simulations are based on inputs that summarize the current condition of the capital markets as of June 30, 2020. Therefore, the first 12-month period of simulated returns represents the period from June 30, 2020 through June 30, 2021, and not necessarily the calendar year of 2020. A description of these technical assumptions is available on request.

(g) Tax Implication

Before making any asset allocation decisions, an investor should review with his/her tax advisor the tax liabilities incurred by the different investment alternatives presented herein including any capital gains that would be incurred as a result of liquidating all or part of his/her portfolio, retirement-plan distributions, investments in municipal or taxable bonds, etc. AB does not provide tax, legal, or accounting advice. In considering this material, you should discuss your individual circumstances with professionals in those areas before making any decisions.

(h) Tax Rates

AB's Wealth Forecasting Analysis has used the following tax rates for this analysis:

Taxpayer	Scenario	Start Year	End Year	Federal Income Tax Rate	Federal Capital Gains Tax Rate	State Income Tax Rate	State Capital Gains Tax Rate	Tax Method Type
Client	A	2021	2060	see below	see below	see below	see below	Top Marginal Rates
Client	B	2021	2060	see below	see below	see below	see below	Top Marginal Rates
Client	C	2021	2060	see below	see below	see below	see below	Top Marginal Rates
Client	D	2021	2060	see below	see below	see below	see below	Top Marginal Rates
Children's Trust (Taxable)	A	2021	2060	see below	see below	13.3%	13.3%	
Children's Trust (Taxable)	B	2021	2060	see below	see below	13.3%	13.3%	
Children's Trust (Taxable)	C	2021	2060	see below	see below	13.3%	13.3%	
Children's Trust (Taxable)	D	2021	2060	see below	see below	13.3%	13.3%	

The federal income tax rate represents AB's estimate of either the top marginal tax bracket or an "average" rate calculated based upon the marginal rate schedule. The federal capital gains tax rate is represented by the lesser of the top marginal income tax bracket or the current cap on capital gains for an individual or corporation, as applicable. Federal tax rates are blended with applicable state tax rates by including, among other things, federal deductions for state income and capital gains taxes. The state income tax rate represents AB's estimate of the 'average' rate calculated based upon the applicable state's marginal tax schedule. Where an applicable state tax code permits the exclusion of a portion of capital gain income from gross income for purposes of calculating state income tax such exclusions have been included in the calculation.

(i) Taxable Trust

The Taxable Trust is modeled as an irrevocable tax-planning or estate-planning vehicle with one or more current beneficiaries and one or more remainder beneficiaries. Annual distributions to the current beneficiary may be structured in a number of different ways, including 1) an amount or a percentage of fiduciary accounting income (FAI) (which may be defined to include part or all of realized capital gains); 2) FAI plus some amount of principal, expressed as a percentage of trust assets or as an amount; 3) an annuity, or fixed dollar amount, which may be increased annually by inflation or by a fixed percentage; 4) a unitrust, or annual payment of a percentage of trust assets, based on the trust's value at the beginning of the year or averaged over multiple years; or 5) any combination of the above four payout methods. The annuity/fixed dollar amount payout method can be set to distribute a pretax or after-tax amount. After-tax amounts increase the distribution from the trust to achieve the specified amount after-taxes for the beneficiary. The other payout methods all allow for minimum and maximum parameters that also may be set as pretax or after-tax amounts. The trust will pay income taxes on retained income and will receive an income distribution deduction for income paid to the current beneficiaries. Capital gains may be taxed in one of three ways, as directed: 1) taxed entirely to the trust; 2) taxed to the current beneficiaries to the extent the distributions exceed traditional income; or 3) taxed to the current beneficiaries on a pro rata basis with traditional income.

(j) Intentionally Defective Grantor Trusts (IDGTs)

The Intentionally Defective Grantor Trust (IDGT) is modeled as an irrevocable trust whose assets are treated as the grantor's for income tax purposes, but not for gift or estate tax purposes. Some income and transfer-tax consequences associated with transfers to and the operation of an IDGT remain uncertain, and the strategy may be subject to challenge by the IRS. Hence, this technique requires substantial guidance from tax and legal advisors. The grantor may give assets to the trust, which will require using gift tax exemptions or exclusions, or paying gift taxes. The IDGT is modeled with one or more current beneficiaries, and one or more remainder beneficiaries. Distributions to the current beneficiaries are not required, but the system permits the user to structure annual distributions in a number of different ways, including 1) an amount or a percentage of fiduciary accounting income (FAI) (which may be defined to include some or all realized capital gains); 2) FAI plus some principal, expressed either as a percentage of trust assets or as a dollar amount; 3) An annuity, or fixed dollar amount, which may be increased annually by inflation, or by a fixed percentage; 4) A unitrust, or annual payment of a percentage of trust assets, based on the trust's value at the beginning of the year, or average over multiple years; or 5) any combination of the above four payout methods. Because the IDGT is modeled as a grantor trust, the system calculates all taxes on income and realized capital gains that occur in the IDGT portfolio each year, based on the grantor's tax rates and other income, and pays them from the grantor's personal portfolio. The IDGT may continue for the duration of the analysis, or the trust assets may be distributed in cash or in kind at a specific point in time or periodically to (1) a non-modeled recipient, (2) a taxable trust, or (3) a taxable portfolio for someone other than the grantor. If applicable, an installment sale to an IDGT may be modeled as a user-entered initial "seed" gift followed by a sale of additional assets to the trust. The system will use one of two methods to repay the value of the sale assets plus interest (less any user-specified discount to the grantor): 1) user-defined payback schedule, or 2) annual interest-only payments at the applicable federal rate (AFR) appropriate for the month of sale and the term of the installment note, with a balloon payment of principal plus any unpaid interest at the end of the specified term.

17 The term "GRAT" is an acronym for "Grantor Retained Annuity Trust." A GRAT is a trust to which a grantor contributes assets and retains the right to receive fixed annuity payments for a specified number of years. If the grantor survives the term, the funds remaining in the GRAT pass to the beneficiaries directly or in trust, without gift or estate tax. See "The Path from GRAT to Great: Efficient Wealth Transfer with Grantor Retained Annuity Trusts," Bernstein Private Wealth Management (2016), for an in-depth discussion of GRATs.

18 See Treasury Regulations § 25.2702-3(b)(4).

19 The complications Mary encountered could have been mitigated if a trust that was deemed a qualified purchaser was the remainder beneficiary of the GRAT. In the alternative, Mary could have explored reacquiring the alts from the GRAT, for cash or marketable securities, prior to the distribution of the remainder.

20 The SEC has determined that a distribution from a trust to a beneficiary may not transfer qualified purchaser status because the determination is made by a facts and circumstances determination. See Arlene Osterhoudt and Ivan Taback, "Securities Law Considerations for Trusts and Estates Advisors: Part 1," Trusts & Estates 23 (July 2016), citing American Bar Association (ABA), SEC No-Action Letter, 1999 SEC No-Act, LEXIS 456 (April 22, 1999).

21 The investor may trigger gift tax on the transfer if the investor does not have sufficient applicable exclusion amount remaining to shield the gift.

22 § 2702.

23 A secondary fund focuses on buying interests from limited partners or general partners of existing private equity funds. See icapitalnetwork.com, "Secondary Private Equity Funds: Diversified Private Equity Exposure with an Attractive Risk Profile," Kunal Shah and Tatiana Esipovich, April 27, 2020.

24 Osterhoudt and Taback, and accompanying text, supra note 20.

25 See Uniform Prudent Investor Act, American Law Institute Third Restatement of the Law of Trusts (1992).

26 The 1933 Act is codified at 15 U.S.C. §§ 77a-77mm.

27 Rule 506 of Regulation D under the 33 Act.

28 Id.

29 Section 3(c)(7) of the 1940 Act. The 1940 Act is codified at 15 U.S.C. §§ 80a-1 through 80a-64.

30 Id.

31 Section 2(a)(51(A) of the 1940 Act.

*Bernstein does not obtain fees from our wealth forecasting analysis. We are only paid on assets under management.

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The Bernstein Wealth Forecasting System

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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