The art of the tax reform deal

President Donald Trump’s business pedigree played a leading role in his successful campaign. And since Election Day, those credentials coupled with his pro-growth agenda have set U.S. stock markets on a continuing upward slope. The new administration’s stimulative rhetoric and the acutely sympathetic market reaction have now resulted in outsized expectations for major fiscal reform. However, the market can only hitch its wagon to a promissory star for so long. Investors are justifiably wondering: Having talked the talk—banged home again in his address to Congress—will he indeed walk the walk? Failure to do so would almost certainly result in a market reversal as impressive in magnitude as the run-up experienced over the past three months.

Essentially, the president will have to indulge in some challenging political horse-trading among stimulative tax cuts, spending initiatives, spending cuts, and revenue boosters. For example, while both sides of the aisle share the goal of cutting corporate taxes from the current 35% rate to somewhere closer to 20%, the Senate—through its majority leader Mitch McConnell (R-KY)—has made clear its hostility to legislation that would meaningfully expand the federal deficit. The Republicans are eight seats shy of the 60 needed to pass the president’s corporate tax initiative, which is at the core of his broader growth program. In our view, without tax reform, the overall program will implode. Consequently, understanding the potential for continued market ascension requires a careful study of the possible means of funding corporate tax reform and handicapping the chances of the promised outcome. While we do see a number of realistic paths to the sought goal, we are not placing much faith in the now well-tread topic of border adjustment tax.
The proposed border adjustment tax (BAT) has generated controversy springing from the fact that it is untried, could be very disruptive, might violate existing trade agreements, and could potentially even spark a trade war. The BAT would implicitly subsidize exports by not taxing firms for sales made abroad. At the same time, importers would no longer be able to deduct the cost of their imported products, thereby increasing their tax base substantially. Importers are crying foul, but supporters of the BAT argue that those importers would be unharmed because, theoretically, the BAT would lead to an appreciation of the U.S. dollar (USD) that would lower the cost of their imported goods. But under a hypothetical 20% corporate tax rate, it would require a 25% appreciation of the USD for that no-harm-to-importers scenario to occur. To put this in perspective, Figure 1 takes a multi-decade look at the DXY Currency Index, which represents a basket of major currencies against the USD, with a star marking where a 25% increase would bring it. The dollar would be trading at levels not seen since the 1980s.

A higher USD would, in our view, injure many, including U.S. manufacturers, farmers, and those in the tourist trade. In addition, USD-denominated debt would mean higher amounts owed by foreign issuers, setting off repayment struggles, particularly in emerging markets. The overall impact of a BAT would likely be an increase of about $120 billion in tax revenue per year—with most of it coming out of the pockets of U.S. consumers one way or another.
If these economic issues are not enough, there are prospective legal hurdles from the World Trade Organization. Ultimately it could look at the combination of no taxes on export earnings and the lack of deductibility for imports as a protectionist policy. Our trading partners could decide to retaliate, perhaps leading to a trade war. Given all of this, we see little reason to believe that a BAT will survive, leaving open the question of how to regain lost BAT-related revenue. Luckily, there are options, such as:

**Tax reform without border adjustment**

One plausible alternative is as follows:

- Corporate tax rate would be cut to around 23% versus the current 20% target
- Expensing business spending at 100% would be in place for four years
- Existing corporate deductions and credits are trimmed, making up for much of the lost benefit from the BAT tax removal
- A revenue-neutral one-time “deemed repatriation” could lubricate the wheels and induce passage

**Straight tax cut**

Advocated by President Trump from the inception of his campaign, this Reaganesque cut-now-reform-later alternative is a fairly simple option and its passage would be likely. Cuts would be temporary and subject to 10-year sunset provisions, as they could not be revenue neutral, and economic growth would be likely to respond positively over the short term.

**Reduced healthcare costs to offset lower taxes**

Should President Trump repeal and replace the Affordable Care Act as he intends, he could ostensibly use freed-up healthcare costs to fund tax cuts. We estimate that the U.S. government spends in the neighborhood of $1 trillion a year on healthcare. Thus, even a 10% reduction—$100 billion—would go a long way to funding the intended corporate tax reduction.

**Hurry up and wait**

The wheels of tax reform grind slowly, making it unlikely to become a reality until well into the second half of this year, and markets will simply have to wait for the tax evolution to bear fruit. However, we should be able to observe the seeds of change taking root. The president has promised to unveil his tax plan later this month while House and Senate tax-writing committees are hard at work.

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* Source: Strategas Research Partners
In the meantime, markets will need to focus on the economic fundamentals. The story here continues to look good as the economy moves ahead in large part due to the underlying reflation trends that materialized last year. After growing 2.7% during the second half of last year, growth in the current quarter is expected to reach a similar level, or about 2.5%, according to the Atlanta Fed GDPNow tracker. Corporate profits appear to be on track for a 6%–7% annual increase for the fourth quarter of 2016. The stronger growth story is bringing back Fed rate hikes as early as possibly this month, in fact without markets flinching, which we view as another sign of underlying strength.

Core narrative

Our Investment Committee met last week and made a minor adjustment to our portfolios’ tactical asset allocation, removing 1% from Taxable High-Yield, bringing this asset class to a neutral weight, given recent moves that have left yield spreads at the tightest levels seen since the financial crisis. There is also growing concern that leverage for issuers of high-yield taxable debt has increased substantially. These funds were redeployed to liquid alternatives and hedge funds for High-Net-Worth Tax-Advantaged and Institutional strategies, respectively. The addition to alternative investments is designed to provide portfolios with return diversification that includes both long and short U.S. stock exposure as well as significant non-U.S. betas.

We did not make any changes to portfolios utilizing high-yield municipal bonds as they trade differently than high-yield taxable bonds. Municipals are more dependent on flows from high-net-worth investors. Also, the financial conditions for high-yield municipal issuers have improved, and infrastructure spending could further aid this asset class.

I encourage you to read this month’s In Focus: “Pension plans and the glide path strategy.” Although it clearly has an institutional bent, it should be of interest to all who are seeking success in a low-rate, low-return world. And who isn’t?

With that, I leave you until next month, when we will have ushered in spring.

Best,

Tony

* Source: Atlanta Fed GDPNow tracker
Lower interest rates lead to lower discount rates which cause pension plan liabilities to increase, thus negatively affecting corporate pension plans’ “funded status,” i.e., the difference between its assets and liabilities (money owed to pensioners). Funded status took a major hit with the financial crisis of 2008–2009 and the subsequent Great Recession and it has yet to recover. Plan sponsors saw their plans get dinged from both sides as their asset values plummeted and the discount rates used to calculate the value of their liabilities also fell, pushing up those values. According to analysis from Willis Towers Watson, Fortune 1000 pension plans’ aggregate funding levels fell from an average of 103% in the two years prior to the crisis to as low as 77% in 2012, and are estimated to only be around 80% in 2016.

Persistently low rates have forced plan managers to take on higher investment risk in an effort to boost returns. Back in 1995, for example, achieving a healthy 7.5% return was possible with a simple, bond-only portfolio (Figure 1). Today, however, plan sponsors must consider allocating assets among stocks and/or across alternative investments in an effort to realize that same 7.5% return. Some of these “risk assets” (where the return is uncertain) invariably add volatility to the plan assets, which can lead to further issues when portfolios are subject to drawdown—the significant loss of capital lasting an extended period of time.

Hopefully, with interest rates currently rising, the landscape may start to turn. For now, however, let’s take a look at how sponsors can pursue attractive, competitive returns in a low-return environment and thereby “de-risk” pension plans.

The glide path strategy

“Glide path” is the new catchphrase in pension risk management. It reflects the desire to de-risk over time and achieve gains in funded status, with the end goal of a fully funded plan ready to be held long term, or available for annuity purchase and termination.
A glide path strategy seeks to help reduce volatility of the funded status, that is “de-risk” the plan, without sacrificing return goals by increasing asset interest rate sensitivity (duration) while reducing stock exposure over time. Though the endgame of de-risking along a glide path strategy can be a fully funded plan with a long-term matched bond portfolio, plan sponsors can choose other options, which may include: immunization where assets and liabilities are matched against any changes in the yield curve; taking even bigger steps to pay employees a lump sum; or selling the plan to an insurance company, which would then guarantee payouts going forward. For the pension plan sponsor or corporation, this end state means the plan is no longer likely to present unpredictable cost demands that can wreak havoc on earnings. The typical U.S. plan is underfunded and can improve funded status through some combination of contributions, higher interest rates, and potentially, excess returns from risk assets and active management.

Before delving into the details of our methods, we outline the standard approach to glide path analysis as follows (Figure 2):

- The glide path starts at a relatively low (<85%) funded status
- Initially, 60% or more of the assets are invested in stocks that are diversified globally and across market capitalizations
- The glide path defines trigger points to sell stocks and buy bonds. These

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For illustrative purposes only. Actual results vary from forecast results, and other allocations may have performed better than those illustrated. Investing involves risks and you may incur a profit or a loss.


<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Expected return</td>
<td>7.5%</td>
<td>7.5%</td>
<td>7.7%</td>
</tr>
<tr>
<td>Standard deviation</td>
<td>6.0%</td>
<td>7.6%</td>
<td>14.4%</td>
</tr>
</tbody>
</table>

The typical U.S. plan is underfunded and can improve funded status through some combination of contributions, higher interest rates, and potentially, excess returns from risk assets and active management.
trigger points are based on improvements in funded status of as little as 0.5% or as much as 10%, but are usually between 2%–5%.

**Customizing the glide path strategy**

Rather than a one-size-fits-all approach, we focus on each plan sponsor’s objectives, developing what we believe are better, flexible, and dynamic glide paths that can be customized using the following methods:

**Expanded and diversified risk assets.** While stocks naturally comprise a significant component of risk assets, diversification is critical. For example, earning asset pools can also include fixed income investments such as high yield, emerging markets debt, and multi-sector strategies, where these assets offer an adequate potential risk/return profile.

Some clients also incorporate limited use of illiquid investments, particularly when the glide path timeframe to full funding exceeds five years. This group could consist of traditional seasoned private market asset classes, as well as select opportunities with well-defined exits, such as distressed lending.

**Dynamic de-risking (and re-risking).** Glide paths are designed to be dynamic. As funded status improves, less portfolio risk is taken, reducing the likelihood of falling back. Some plan sponsors have taken this approach a step further by looking at the source of improved funded status in the implementation of de-risking. With this approach, a dynamic glide path can capture both gains in risk assets by rebalancing, and drops in liabilities by extending duration after a
rise in rates. This type of strategy requires frequent monitoring. Some plan sponsors have also adopted glide paths that “re-risk,” that is, they take more portfolio risk in the event that funded status falls due to a market downturn. Surveys indicate that about one-third of sponsors with glide paths have a re-risking program. We find that re-risking is usually not the mirror image of de-risking; most common is a re-risking plan whose triggers are wider than those for de-risking. For example, a plan that de-risks after a 2% increase in funded status would only re-risk if funded status fell by 4%. Another approach is to have de-risking automatically follow a preapproved schedule, while re-risking requires a discussion by the investment committee.

Our analysis of re-risking clearly shows there are environments that can help grow funded status more quickly after a short-term loss in stock markets or decrease in yields. However, there are also times when markets have significant momentum, and a contrarian approach that buys low keeps buying lower. Over the long term, including the rising rates of the 1970s, a glide path that re-risked in addition to de-risking would not only have had higher funded status, but also higher funded status volatility. Since the ultimate objective of a glide path is a fully funded matched portfolio, the opportunity for higher funded status beyond 120% may not be worth the increased volatility.

For over 30 years, interest rates have trended lower, limiting the ability to de-risk, since calculated liabilities increase as yields fall. However, there have been many short-term increases in yields and periods of high returns in risk assets that could trigger a glide path de-risking. The problem is that these gains can disappear as quickly as they appeared, especially when measuring funded status quarterly and making decisions several weeks into the quarter. Monthly measurement is a little better, but still misses many opportunities. For this reason, many plan sponsors have moved to daily monitoring of funded status. When daily monitoring is linked to an automatic glide path execution schedule, a plan has the best chance to capture gains in funded status as they appear. Ultimately, a plan wants to reach a permanently funded status where it can achieve a duration match of its assets and liabilities. Getting there through the re-risk/de-risk process entails picking up incremental asset gains that, over time, accumulate and eventually put the plan in its permanently funded condition. To be clear, daily monitoring is not about frequent trading; it is about seeking to harvest gains efficiently. It does require a diligent support system dedicated to methodology, measurement, and execution.

We believe there is significant potential to better meet objectives along the glide path by using capital-efficient and diverse assets, dynamic frequent monitoring, and planning for a successful landing.

To learn more about how these insights could benefit your plan, contact your Relationship Manager.
**Equities**

**Capital Perspectives**

**As of February 28, 2017**

<table>
<thead>
<tr>
<th>GICS sector</th>
<th>OUR ASSESSMENT</th>
<th>U.S. large-cap sector allocations</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Macroeconomic</td>
<td>Quantitative</td>
</tr>
<tr>
<td>Financials</td>
<td>1</td>
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<tr>
<td>Telecom</td>
<td>2</td>
<td>3</td>
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<tr>
<td>Technology</td>
<td>3</td>
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<tr>
<td>Industrials</td>
<td>4</td>
<td>5</td>
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<tr>
<td>Healthcare</td>
<td>5</td>
<td>4</td>
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<tr>
<td>Discretionary</td>
<td>6</td>
<td>9</td>
</tr>
<tr>
<td>Utilities</td>
<td>7</td>
<td>1</td>
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<td>Staples</td>
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<td>2</td>
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<td>Materials</td>
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<td>6</td>
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<td>Energy</td>
<td>10</td>
<td>10</td>
</tr>
<tr>
<td>REITs</td>
<td>11</td>
<td>11</td>
</tr>
</tbody>
</table>

Sources: Bloomberg, WTIA

**Month to date** | **Year to date** | **Trailing 12-month return**
---|---|---
S&P 500 | 4.0% | 5.9% | 24.9%
Russell 2000 | 1.9% | 2.3% | 36.1%
MSCI EAFE | 1.4% | 4.4% | 15.8%
MSCI Emerging Markets | 3.1% | 8.7% | 29.5%

Sources: FactSet, Bloomberg. Investing involves risks and you may incur a profit or a loss. Past performance is no guarantee of future results.

**U.S. Equities**
- Equity markets continued to perform strongly in February rising more than 4%
- Healthcare, technology, and financials led performance last month while energy, telecom, and materials were flat to declining
- Small caps underperformed large caps, as prospects for lower tax rates are pushed out further in time
- We remain positive on equities over the next year as fiscal stimulus is likely to provide further support; however, with each passing month, the size of the ultimate stimulus becomes increasingly important in assessing market valuation

**International Equities**
- We expect European stocks to keep outperforming those of Japan, particularly on a U.S. dollar basis
- European companies’ earnings are leveraged to improving economic growth, at home and in emerging markets (EM); also, European multiples have room to expand
- We expect elections in the Netherlands, France, Germany, and Italy, plus the launch of U.K.—European Union negotiations on Brexit will cause bouts of market volatility but not derail fundamentals
- EM stocks are likely to keep improving on the strength of Asian equities (levered to structural consumer growth) and Latin American and Russian equities (levered to the commodities recovery)

**Our sector inputs and allocations, as of March 1, 2017**

**Sources:** Bloomberg, WTIA

**Benchmark:** Russell 1000

**Current allocation**

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**Fixed Income**

### AS OF FEBRUARY 28, 2017

<table>
<thead>
<tr>
<th>Index</th>
<th>Month to date</th>
<th>Year to date</th>
<th>Trailing 12-month return</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bloomberg-Barclays U.S. Aggregate Bond Index</td>
<td>0.7%</td>
<td>0.9%</td>
<td>1.4%</td>
</tr>
<tr>
<td>Bloomberg-Barclays U.S. Investment Grade Credit Index</td>
<td>1.1%</td>
<td>1.5%</td>
<td>5.7%</td>
</tr>
<tr>
<td>Bloomberg-Barclays Ba High Yield Index</td>
<td>1.1%</td>
<td>2.2%</td>
<td>14.8%</td>
</tr>
<tr>
<td>Bloomberg-Barclays 60% High Yield Total Return/40% Municipal Total Return Index</td>
<td>1.7%</td>
<td>2.8%</td>
<td>3.2%</td>
</tr>
<tr>
<td>Bloomberg-Barclays U.S. Mortgage Backed Securities Index</td>
<td>0.5%</td>
<td>0.4%</td>
<td>0.4%</td>
</tr>
<tr>
<td>S&amp;P Municipal Bond Index</td>
<td>0.7%</td>
<td>1.2%</td>
<td>0.8%</td>
</tr>
<tr>
<td>S&amp;P Municipal Bond New York Index</td>
<td>0.6%</td>
<td>1.1%</td>
<td>0.5%</td>
</tr>
<tr>
<td>S&amp;P Municipal Bond California Index</td>
<td>0.7%</td>
<td>1.3%</td>
<td>0.4%</td>
</tr>
</tbody>
</table>

Sources: FactSet, Bloomberg.

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### U.S. Treasuries

- Treasuries continue trading at 2.50%–2.30% yield for the 10-year note
- Market needs to see action on tax cuts and infrastructure spending before resuming the upward yield trajectory
- Fears of a “Frexit” contribute to lower U.S. and global yields, with the U.S. 30-year falling 10 basis points, or bps, (0.10%) in Feb.

### Investment-Grade (IG) Corporates

- IG credit began 2017 positively with risk premiums contracting; potential for lower corporate tax rates and less regulation has so far supported risk assets
- Financials have outdone industrials so far this year, a steeper yield curve and lighter regulation should help bank profitability, though reduced capital or liquidity standards would be a negative to bondholders
- Modest increase in risk-free rates more than offset by tighter credit spreads
- After a slow end to 2016, primary market activity increased significantly as companies looked to issue debt ahead of higher rates; financials drove new issue volume during the first half of the month—mainly U.S. banks issuing debt to meet new regulatory requirements—with bank issuance supplemented by three large industrial deals

### High-Yield Corporates

- Positive results have been posted thus far in 2017, with CCCs outperforming Bs and BBs
- Leveraged loans have had slight positives so far this year with CCCs over Bs and BBs
- In primary market activity, overall 86 new high-yield bonds have priced for $47.2bn YTD, up 261% compared with the paltry $13.1bn over the same period in 2016
- Primary market activity in the leveraged loan market remains near record levels as YTD new loan volume totaled $189.9bn, compared to a meager $17.3bn that priced over the same period in 2016
- The surge in leveraged loan volume has been due to a wave of re-pricing activity, accounting for about 55% of gross volume as investors prepare to see loans price higher as the Fed nudges up rates

### Municipal Bonds

- Investors seem wary of uncertainty ahead as far as tax reform’s potential impact on the market and fiscal policy initiatives that may have positive or negative effects on muni supply and demand
- We gauge investors to be weary by their buying patterns; flows into tax-exempt funds continue to be positive (a big change from November), but lack enthusiasm
- Without a committed buyer base, we could see greater rate volatility ahead

### International

- Euro- and yen-denominated sovereign bonds are likely to continue to be unattractive
- European and Japanese bond yields appear to have greater upside potential than downside; also, there is risk of additional U.S. dollar (USD) appreciation, which could further depress returns in USD terms
- USD-denominated emerging markets (EM) bonds have long durations, and thus are exposed to likely further increases in Treasury yields; on the other hand, major EM currencies (which suffered a drop after the U.S. election) have appreciated thus far in 2017 and higher oil prices have supported the budgets of oil-producing sovereigns, leading to narrow credit spreads

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*Capital Perspectives*
ASSET CLASS OVERVIEW

Real Assets and Nontraditional

<table>
<thead>
<tr>
<th>Hedge Fund Research Institute Indexes</th>
<th>AS OF FEBRUARY 28, 2017</th>
<th>Month to date</th>
<th>Year to date</th>
<th>Trailing 12-month return</th>
</tr>
</thead>
<tbody>
<tr>
<td>Global</td>
<td></td>
<td>1.1%</td>
<td>1.6%</td>
<td>7.5%</td>
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<tr>
<td>Equity Hedge</td>
<td></td>
<td>1.2%</td>
<td>2.0%</td>
<td>8.2%</td>
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<tr>
<td>Event Driven</td>
<td></td>
<td>1.6%</td>
<td>2.6%</td>
<td>18.4%</td>
</tr>
<tr>
<td>Macro</td>
<td></td>
<td>1.2%</td>
<td>0.2%</td>
<td>−3.9%</td>
</tr>
<tr>
<td>Relative Value</td>
<td></td>
<td>0.6%</td>
<td>1.3%</td>
<td>5.2%</td>
</tr>
</tbody>
</table>

Sources: FactSet, Bloomberg.
Investing involves risks and you may incur a profit or a loss. Past performance is no guarantee of future results.

Real Assets
• Developed real estate started the year off positively, rallying along with stocks in January and especially in February
• After the first year of gains since 2010, commodity markets treaded water in early 2017 with prices of energy falling and rising for other commodities, such as precious metals.

Nontraditional Hedge
• Hedge funds began 2017 strongly with directional strategies such as long-biased equities and event-driven special situations leading the way
• Macro lost money in January but more than made up for it with a very strong February, led by trend-following managers

Nontraditional Private Markets
• With roughly $350bn, private equity fundraising reached a post-recession high in 2016, though activity is still not back to levels reached in 2007–2008
• Despite valuation fears in venture-backed tech companies, venture capital funds raised $50bn in 2016, the most since 2000; this number likely understates the amount of capital looking to invest in early-stage companies, as many large corporations have grown their internal venture arms
**Investment positioning**

**Portfolio targets effective March 1, 2017 for high-net-worth clients with nontraditional assets**

<table>
<thead>
<tr>
<th>Asset Class</th>
<th>Aggressive</th>
<th>Growth &amp; Income</th>
<th>Conservative</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Equities</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>U.S. Large-Cap Core*</td>
<td>23.0%</td>
<td>26.5%</td>
<td>—</td>
</tr>
<tr>
<td>U.S. Large-Cap Sectors*</td>
<td>23.0%</td>
<td>19.8%</td>
<td>—</td>
</tr>
<tr>
<td>U.S. Small-Cap</td>
<td>13.8%</td>
<td>13.8%</td>
<td>—</td>
</tr>
<tr>
<td>International Developed</td>
<td>19.5%</td>
<td>19.6%</td>
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</tr>
<tr>
<td>International Emerging Markets</td>
<td>9.7%</td>
<td>10.2%</td>
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</tr>
<tr>
<td>Total Equities</td>
<td>89.0%</td>
<td>89.8%</td>
<td>0.0%</td>
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<tr>
<td><strong>Fixed Income</strong></td>
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<td></td>
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<tr>
<td>U.S. Investment Grade–Tax-Exempt</td>
<td>0.0%</td>
<td>0.0%</td>
<td>—</td>
</tr>
<tr>
<td>High-Yield–Tax-Exempt</td>
<td>0.0%</td>
<td>0.0%</td>
<td>—</td>
</tr>
<tr>
<td>Total Fixed Income</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
</tr>
<tr>
<td><strong>Real Assets</strong></td>
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<tr>
<td>U.S. Inflation-Linked Bonds</td>
<td>0.8%</td>
<td>1.0%</td>
<td>—</td>
</tr>
<tr>
<td>U.S. REITs</td>
<td>0.8%</td>
<td>0.5%</td>
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<tr>
<td>Non-U.S. REITs</td>
<td>2.5%</td>
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<td>Total Real Assets</td>
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<td><strong>Nontraditional Hedge</strong></td>
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<td>5.0%</td>
<td>0.0%</td>
</tr>
<tr>
<td><strong>Cash &amp; Equivalents</strong></td>
<td>2.0%</td>
<td>2.3%</td>
<td>0.0%</td>
</tr>
<tr>
<td><strong>Totals</strong></td>
<td>100.0%</td>
<td>100.0%</td>
<td>—</td>
</tr>
</tbody>
</table>

* Large-cap allocations are broken down into the portion designated for use with active or passive managers (U.S. large-cap core) and the portion using our Sector Allocation Strategy (U.S. large-cap core sectors). Tactical positions are shown on page 9 in the graph "Our sector inputs and allocations." Source: Wilmington Trust Investment Advisors, Inc. (WTIA)

Note: Rounding errors may cause the allocation subtotals of some asset classes to differ slightly from the building blocks of their allocations.

Our reference allocations are developed from our long-term economic outlook, reflecting our highlighted themes as well as the insights of our investment and economic professionals. Reference allocations serve as a baseline strategic allocation for long-term investors. The expected returns presented constitute the informed judgments and opinions of Wilmington Trust about likely future capital market performance. No assurance can be given as to actual future market results or the results of Wilmington Trust’s investment products and strategies. Strategy forecasts are derived from the expected return and volatility assumptions in Wilmington Trust’s Capital Markets Forecast 2017, which is available on www.WilmingtonTrust.com or upon request from your Investment Advisor. A description of the process used to develop these numbers can be found in the disclosures section under Forecasted Performance. Return projections are pre-tax and pre-fees. Volatility (standard deviation of return) estimates are based on pre-tax return projections.

There is no assurance that forecast results will be realized or that any investment strategy will be successful.

Please see disclosures for information about our asset allocation strategies, risk assumptions, performance forecasts, fee assumptions, and other important information.
Positioning in response to our outlook

A big-picture glimpse of our overall positions, as of March 1, 2017 (for high-net-worth investors)

Based on current Growth & Income Strategy for High-Net-Worth with Nontraditional (liquid alternatives), this chart represents current weights relative to our strategic asset allocations with high and low boundaries reflecting maximum and minimum weightings.

Our positioning is as follows:

- Neutral to cash, and liquid alternatives markets
- Underweight fixed income
- Slightly overweight domestic large-cap, international developed, and emerging markets
- Slightly overweight tax-exempt high yield
- Overweight real assets due to opportunities in U.S. TIPS

* Large-cap allocations are broken down into the portion designated for use with active or passive managers (U.S. large-cap core) and the portion using our Wilmington Trust Sector Allocation Strategy (U.S. large-cap core sectors).

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Indexes are not available for direct investment. Investment in a security or strategy designed to replicate the performance of an index will incur expenses, such as management fees and transaction costs that would reduce returns.

Past performance is no guarantee of future results. Investing involves risk, and you may incur a profit or a loss.

An overview of our asset allocation strategies:

Wilmington Trust offers seven asset allocation models for taxable (high net worth) and tax-exempt (institutional) investors across five strategies reflecting a range of investment objectives and risk tolerances: Aggressive, Growth, Growth & Income, Income & Growth, and Conservative. The seven models are High-Net-Worth (HNW), HNW with Liquid Alternatives, HNW with Private Markets, HNW Tax Advantaged, Institutional, Institutional with Hedge LP, and Institutional with Private Markets. As the names imply, the strategies vary with the type and degree of exposure to hedge strategies and private market exposure, as well as with the focus on taxable or tax-exempt income. On a quarterly basis we publish the results of all of these strategy models versus benchmarks representing strategic implementation without tactical tilts.

Model Strategies may include exposure to the following asset classes: U.S. large-capitalization stocks, U.S. small-cap stocks, developed international stocks, emerging market stocks, U.S. and international real asset securities (including inflation-linked bonds and commodity-related and real estate-related securities), U.S. and international investment-grade bonds (corporate for Institutional or Tax Advantaged, municipal for other HNW), U.S. and international speculative grade (high-yield) corporate bonds and floating-rate notes, emerging markets debt, and cash equivalents. Model Strategies employing nontraditional hedge and private market investments will, naturally, carry those exposures as well. Each asset class carries a distinct set of risks, which should be reviewed and understood prior to investing.

Forecasted performance:

“Expected returns” for each strategy are derived from our forecast returns for the underlying assets as described in our current Capital Markets Forecast and weighted based on their current allocation percentage. Forecasts are subject to a number of assumptions regarding future returns, volatility, and the interrelationship (correlation) of asset classes. Actual events may differ from underlying assumptions, which are subject to various uncertainties. No assurance can be given as to actual future market results. Expected returns for the individual asset classes are based on factors including, for equity-based securities, dividend growth rates and dividend yield changes. For fixed income securities, expected returns are calculated based on principal impacts from changes in the underlying U.S. Treasury curve, yield spread changes vs. the U.S. Treasury curve, and projections constitute the judgment of Wilmington Trust and are subject to change without notice.
and the interest income that could be earned. Estimates of default rates are also taken into consideration. “Expected standard deviations” are forecast from the trailing 10-year rolling standard deviation of the asset class and “Expected yield” is based on the current expected dividend or interest income and is expressed as a percentage of the underlying principal value.

**Fee assumptions:**
No adjustments are made for advisory fees, transaction costs, or any other expenses. In the course of implementing a given asset allocation, clients could select among a number of investment vehicles or strategies, each of which will have such fees and expenses. These expenses have the effect of reducing returns at a compound rate over time, and would reduce the results shown. In cases where Wilmington Trust, or an affiliate, provides advisory, brokerage, or other services to such an investment vehicle, Wilmington Trust may benefit directly or indirectly from those advisory, brokerage, or other fees. **Investors should develop a thorough understanding of the fees, expenses, and other costs of any investment prior to committing funds.**

**Impact of fees:**
The following is a hypothetical example of the impact over time of fees charged to a client’s account. It is not meant to suggest actual fees, which may vary, and does not reflect actual returns. Assuming an initial investment of $1,000,000 account value and an average annual return of 10%, an annual fee of 100 basis points (i.e., 1.00%) would result in account level fees of $10,641 the first year, $35,351 over three years, and $65,458 over five years. A schedule of Wilmington Trust’s fees is available upon request.

**Actual results will vary from forecast results:**
In the course of implementing a given asset allocation, clients could select among a number of investment vehicles or strategies, each of which would contribute differently to overall results. The returns for individual clients will vary depending upon the performance of each actual investment vehicle or activity, any restrictions, inception date, timing of rebalancing, actual expenses and fees, and other factors.

**Risk assumptions:**
All investments carry some degree of risk. This publication uses the return volatility, as measured by standard deviation, of asset classes as a proxy for illustrating risk. Volatility serves as a collective, quantitative estimate of risks present to varying degrees in the respective asset classes (e.g., liquidity, credit, and default risks). Certain types of risk may be underrepresented by this measure. **Investors should develop a thorough understanding of the risks of any investment prior to committing funds.**

Quality ratings are used to evaluate the likelihood of default by a bond issuer. Independent rating agencies, such as Moody’s Investors Service and Standard & Poors, analyze the financial strength of each bond’s issuer. Ratings range from Aaa or AAA (highest quality) to C or D (lowest quality). Bonds rated Baa3 or BBB and better are considered “Investment Grade”. Bonds rated Ba1 or BB and below are “Speculative Grade” (also “High Yield”).

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