Keeth, Kopplin and Rhodes
WEALTH MANAGEMENT GROUP
of Wells Fargo Advisors

COMMENTARY

Scott Glover, CFA®
First Vice President - Investment Officer

The Importance of Understanding Risk and Reward

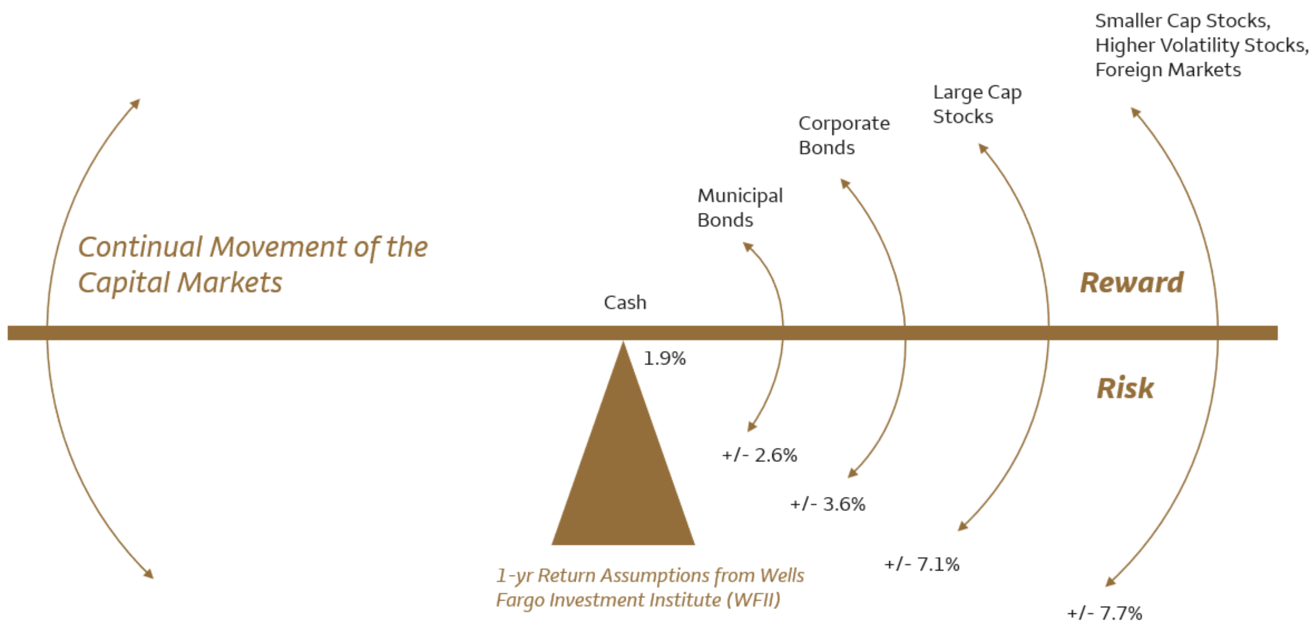
Setting portfolio strategy is one of the most important things an advisor and client ever do together. A portfolio strategy identifies what you are trying to accomplish with your hard-earned assets. It also tells how you are going to accomplish your goal. Finally, a portfolio strategy gives a general expectation of portfolio behavior over longer periods of time. Good portfolio strategies don't just appear, they are the result of an investigative process that is allowed to play out.

Our Philosophy

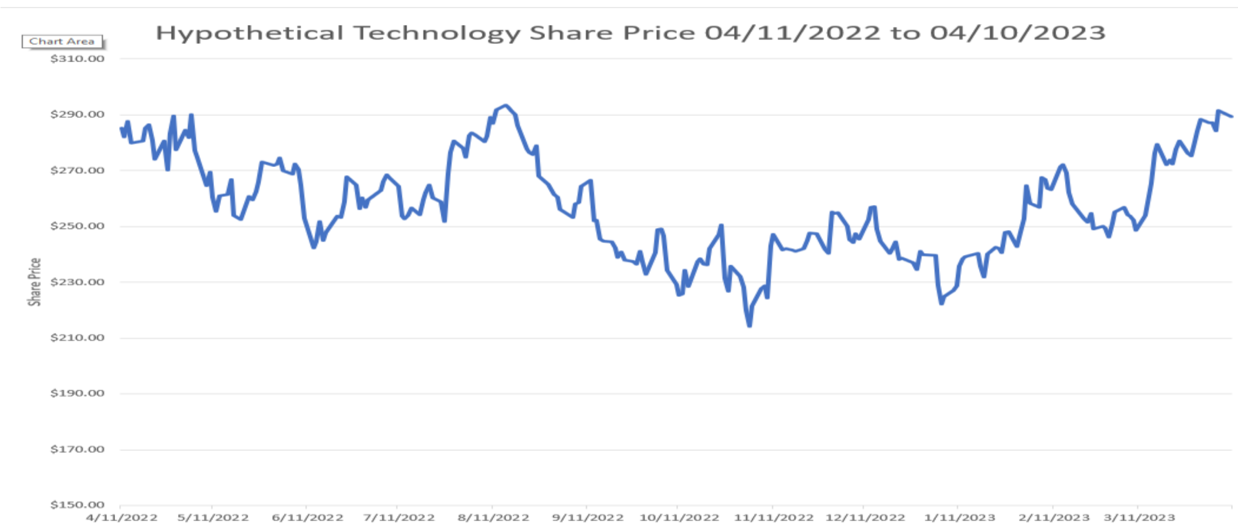
We seek to add value over time through proper planning and rigorous internal research on investments for individual accounts as well as manager selection for advisory accounts, building conviction in investment opportunities through team debate to offer the appropriate reward for the risk we are asking our clients to accept.

A governing principal for all strategies is the idea of risk tolerance. Risk tolerance is a function of how much risk an investor is willing to accept to achieve a potential return. Think of risk and reward in terms of a playground "teeter-totter". An investor's risk is the potential downward movement as the "teeter-totter" moves back and forth. Different asset classes and their associated risk profiles can be thought of as moving away from a "cash" center. Riskier asset classes are the farthest out and subject to the most movement

It's crucial that investors understand these movements are point in time. This means that prices are fluid or constantly moving and might even move beyond the expected lower boundary. Assuming the portfolio is comprised of carefully selected investments, there should be a reasonable expectation that if the "teeter-totter" moves down, it will also move back up in a similar fashion.



To illustrate how the "teeter-totter" can potentially move through time, we show the hypothetical movement of a large cap Technology stock below. On 04/11/2022 the stock closed at $285.26 and on 04/10/2023 it closed at $289.39. Point-to-point, a change of +1.45%. Over the same period, the stock was up at one point +2.61% closing at $292.71 and at one point down -24.89% closing at $214.25.

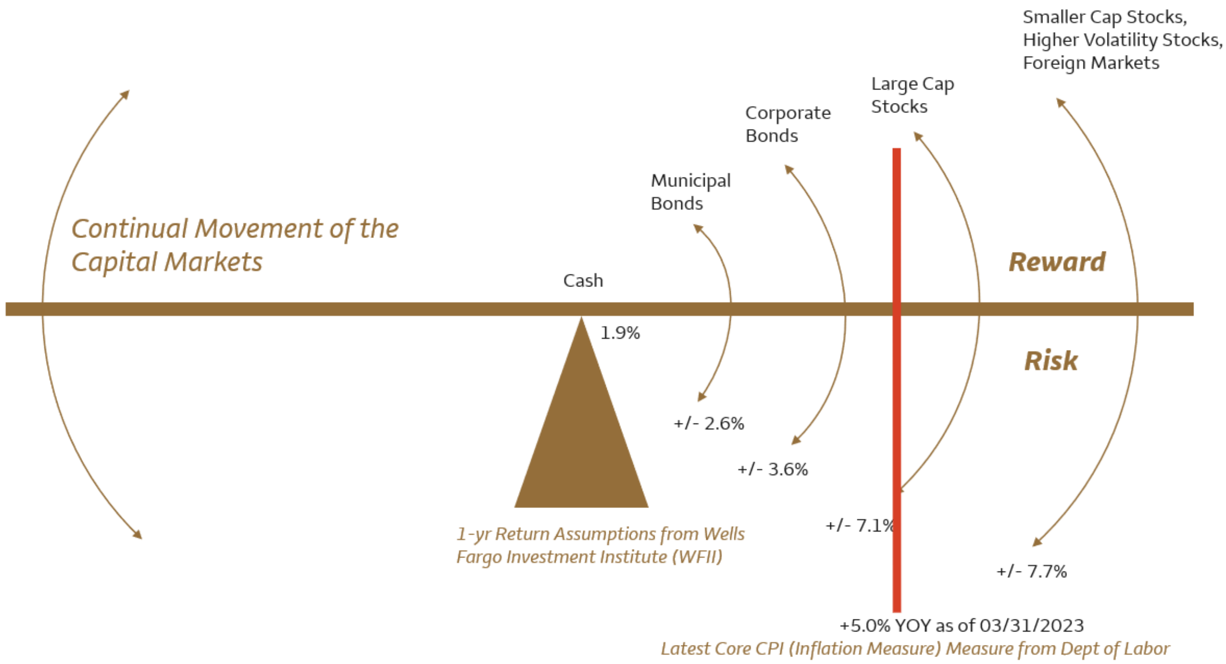


This information is hypothetical and for discussion purposes only. It is not intended to represent any specific return, yield or investment. It is provided for illustrative purposes only and does not constitute a recommendation to invest in any particular fund or strategy and is not a promise of future performance, an estimate of actual returns or of the volatility any client portfolio may experience. Hypothetical results do not represent actual trading and do not reflect the impact of any fee, expenses or taxes applicable to an actual investment. Hypothetical and past performance are no guarantee of future results.

2022 was an exceptional year for volatility, far outside normal expectations. Technology was a sector hit particularly hard by the interest rate increases that came from the Federal Reserve. This example is dramatic, but it does illustrate the general symmetrical nature of volatility and how the "teeter-totter" moves both ways.

An investor understanding their particular risk tolerance helps them to frame their return expectations. If an investor is uncomfortable with the potential point in time downside of a pure stock portfolio, it would be more appropriate for them to have a blend of both stocks and bonds. Referring to our "teeter-totter" analogy, this places them somewhere closer to the center than a pure stock portfolio. Potential point in time lows they could expect during a market sell off shouldn't be as low as a pure stock portfolio. It also means they shouldn't expect the same highs as a pure stock portfolio when the market rallies.

Understanding of risk can also be a useful tool when an investor needs to determine how much risk they need to accept to achieve a particular goal. The Core Consumer Price Index (includes Food and Energy), a measure of inflation, was 5.0% year-over-year as of 03/31/2023. This means that consumers are having to pay, on average, 5% more for the same goods they were buying a year ago. Let's assume an investor wants to construct a portfolio that will beat inflation, but only by taking as much risk as necessary. The resulting portfolio could potentially be a blend of both stocks and bonds with the stock portion only being large enough to achieve the goal of beating annual inflation of 5%.

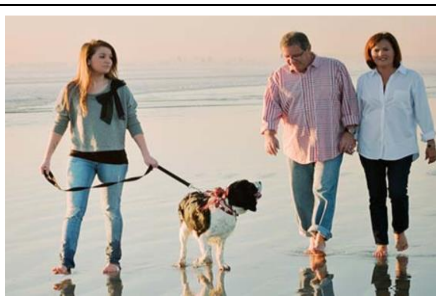


Time is an important factor that investors need to keep in mind when they evaluate risk and reward for developing an appropriate strategy. The average return assumptions for any asset class, from any credible source, are based upon long-term multi-year histories. These average assumptions are also projected forward in the context of long-term, multi-year time horizons. Any 1- or 2-year time frame may deviate either greater or less than the expected return. Investors with a portfolio based upon long term average return expectations need to be patient during a greater than expected deviation. It's often said: "It's time in the market and not timing the market."

We believe having a portfolio strategy in place based upon an understanding of risk tolerance and return expectation brings a higher level of investor satisfaction. Investors better understand why they own the investments in their portfolio. They are also better prepared to cope with unexpected market movements. Conversations between advisor and a client are more productive and focused on measuring progress and potential adjustments to support portfolio strategy. Both parties are then able to execute a repeatable process that helps to maintain the portfolio and achieve the investors goals.

Discussing Your Estate Plan with Family

How much of your estate plan should your family know about?



Why talk with heirs?

Most people don't want to share the exact amount children can expect to inherit. But there can be strong business and family reasons for letting the next generation understand the plans you've made.

If you have children from a prior marriage, it could be wise to have conversations with your spouse or partner and children about what they should expect. Even if you don't provide full details or exact monetary amounts, explaining your intentions can help to reduce the likelihood of future tensions, or even litigation.

Similarly, sharing intentions can be a good approach when you're planning to treat beneficiaries differently. For example, you might leave one adult child his or her inheritance outright and put another's into a trust. In cases like these, it can help to say, "I felt strongly that it was in your best interest."

Whether or not you decide to discuss plans with your family, it's important that your executor or successor trustee knows who your lawyer, financial advisor, banker, and other advisors are—and where to find your important financial information and documents.

Proceed with care

Rather than discussing estate plans in a family meeting, you may be better off doing it in a series of one-on-one conversations. But remember, either path could spark controversy, so talk to your lawyer or someone who has experience in administering trusts before you move forward. Consider reaching out to an experienced counselor who can help you navigate complex family and emotional issues.

Don't Delay

Because people think estate planning is all about death and inheritance, it tends to get put off. But estate planning is also about controlling what happens to your assets if you can't speak for yourself, which can result from a sudden illness or accident.

If your children have children of their own, it's also important for your children to make arrangements for your grandchildren's financial, emotional, and physical care should anything happen to your children.

To help your children get started sooner rather than later, consider introducing them to the team that helped create your estate plan, such as your attorney, financial advisor, and CPA.

Next Steps

- Contact a financial advisor for referrals to local estate planning attorneys.
- Consider consulting your attorney for advice on what to, and what not to, talk about with family.
- Prepare yourself for potential conflicts that may arise as a result.

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Questions to ask if you inherit a trust

Learning that you are a beneficiary can feel overwhelming. Here, find out where to start and what to ask when you become a beneficiary.

David "Chico" Esparza, senior trust advisor with Wells Fargo Wealth & Investment Management, remembers meeting two clients, a brother and sister whose parents had passed away. "Unfortunately, their parents had not discussed their estate plans with the adult children. When the siblings learned they were the beneficiaries of a sizable trust," Esparza recalls, "they had no idea what to do next."

The brother and sister had many questions. Who handles the estate? What are the terms of the trust? And what should their next steps be? "The Bank was appointed as successor trustee, so we explained the timeline and process for settling the trust estate," Esparza says. "It helped to ease their minds to know that professionals would be handling the numerous tasks required for an orderly estate settlement."

As Esparza's clients found, stepping into the role of beneficiary can feel a bit like stepping into the unknown. Here, Esparza offers three suggestions for those in similar situations.

1. Build an advisory team.

A good first step for the beneficiary is to meet with the trustee who is tasked with executing the terms of the trust. It may be an individual, such as a CPA or lawyer, family member, or potentially a corporate trustee such as Wells Fargo Bank.

"There will be a lot of questions, so it's important to establish a communication plan and outline tasks that need to be accomplished along with a general timeline for how long it will take to settle the estate," Esparza says.

In some instances, once the estate is settled, a new trust is funded with the beneficiary's share of the estate; in other cases, assets will be distributed outright to the beneficiary. If the assets will be retained in trust, the trustee collaborates with an investment advisor to help manage the assets according to the terms of the trust.

"The trustee and investment advisor will create a plan that is based on the terms of the trust and considers the needs of the beneficiary," Esparza says. "A best practice is for beneficiaries to seek the guidance of a tax advisor regarding tax implications related to trust distribution."

2. Understand the terms of the trust.

One of the first questions a beneficiary might have is, "What benefits do I have under the trust?" Beneficiaries are well served to seek independent counsel for questions regarding interpretation of their interest under the trust.

Esparza explains that a trust can be a useful tool for holding, managing, and distributing property as outlined by the trustor(s)—the creator(s) of the trust—in the trust agreement, but each trust is unique in how assets can be distributed to beneficiaries. Some common areas of discussion include:

Beneficiary or beneficiaries: Is there a sole beneficiary or several beneficiaries of the trust? How do the terms address the rights different beneficiaries have to distributions from the trust?

Age restrictions: Does the beneficiary have to reach a certain age before accessing some or all of the trust?

Distribution restrictions: Can beneficiaries access the principal or just the income from the trust? Does the beneficiary need to provide the trustee with proof of the beneficiary's own income and expenses to receive distributions? What categories of expenses can the trust cover for the beneficiary? (Trusts have ascertainable standards and can cover health, education, maintenance, and support.) Can distributions be adjusted for inflation?

Lifetime of the trust: Does the trust terminate once the beneficiary reaches a certain age, or is it meant to last the beneficiary's lifetime? Is any portion of the trust designated for future generations?

"Trusts present an opportunity to preserve, accumulate, and transition generational wealth," Esparza says. "For that reason, the trustee should be prudent and equitable in administrating the trust, giving consideration to the current needs of the beneficiary as well as the long-term goals and objectives of the trust."

3. Ask questions before taking distributions.

"Before taking a trust distribution, some beneficiaries find it useful to inquire about the potential tax consequences. That's where a tax advisor should provide guidance," Esparza says. "Beneficiaries also may consider consulting with the trustee and the rest of their advisory team about additional considerations or impacts a trust distribution may have on the investment plan." In addition, beneficiaries should consult with their own legal counsel if they have specific questions regarding their rights with respect to a trust.

Esparza shares the story of a young beneficiary who wanted to use her trust fund to purchase a luxury car when she turned 16. "I posed this question: 'Would a less-expensive car meet your transportation goals and help preserve trust assets for the long term?'" he says. "It is important for beneficiaries to stay connected with the trustee and to ask clarifying questions so they understand the goals and objectives established by the grantor."

Blake Kopplin
Managing Director – Investments
210-489-7676
Blake.kopplin@wellsfargoadvisors.com

Randy Keeth
Managing Director – Investments
210-489-7695
Randal.keeth@wellsfargoadvisors.com

Jim Rhodes
Senior Vice President - Investments
PIM Portfolio Manager
210-489-7679
James.rhodes@wellsfargoadvisors.com

Scott Glover, CFA
PIM Portfolio Manager
Financial Advisor
210-489-7684
Scott.glover2@wellsfargoadvisors.com

Dinah Allerkamp
Senior Client Associate
210-489-7672
Dinah.allerkamp@wellsfargoadvisors.com

KEETH, KOPPLIN AND RHODES
WEALTH MANAGEMENT GROUP
of Wells Fargo Advisors

777 E. Sonterra Blvd, Suite 175
San Antonio, TX 78258
210-404-1120

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WEALTH MANAGEMENT GROUP
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