Wilmington Trust's Paragon

Jack Evans
Head of Investment Planning Operations, Wilmington Trust Investment Advisors, Inc.

John Mongold
Senior Wealth Advisor, Wilmington Trust, N.A.

The analysis that lends clarity to your wealth's complexity

Wilmington Trust's Paragon™—*Portfolio Analysis, Risk Assessment & Goals Optimization*—is our sophisticated, differentiated planning software, whose output reflects the information you provide, as well as our professionals' investment intelligence and capital markets assumptions. Our team's research, experience, and analytics form the basis of the disciplined, economics-led investment process that guides our client portfolios. Only as good as the information it receives, Paragon is part of an integrated, holistic effort designed to help you achieve your goals while taking the least degree of risk.

Once fully informed by the totality of your assets, goals, risk profile, and time horizon, Paragon can be a strategic advantage in developing an approach to fund your various financial goals by:

- Generating a customized asset allocation starting point, based on your goals, risk tolerance levels, returns, your cash flow inputs to determine needs (Figure 1), and our capital markets assumptions
- Reviewing that asset allocation for tax efficient planning
- Stress-testing your portfolio's sensitivity to historical market conditions to see how it may have stacked up against simulated market shocks
- Modeling privately held businesses and stock, a differentiating feature in the industry
- Revealing overly concentrated areas—which may lift the risk impact—plus possible cash flow shortfalls and missed opportunities, in an effort to wholly diversify and balance your portfolio*

By maintaining a focus on success probability targets—and away from the daily market fluctuations—Paragon, together with our goals-based planning approach, can help ensure all facets of your wealth management goals are working in concert. In this paper, we explore the fundamental facets of a Paragon analysis and share the ways in which it may inform an investment plan.

Beginning with the ends in mind

Financial health involves more than wealth, and wealth planning is about much more than one's portfolio. But investment planning is a core component that comprises extensive information-gathering to create a balance sheet and income statement, evaluate spending needs and borrowing capacity, and myriad other elements that can result in the most impactful Paragon analysis.

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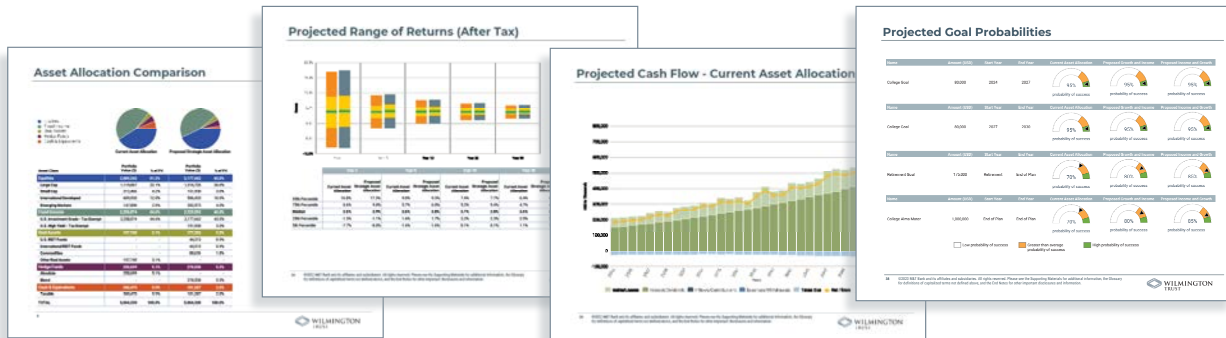
Figure 1: **A brief sampling of what a Paragon analysis can bring to life**



For illustrative purposes only. **Investing involves risks and you may incur a profit or a loss. There is no assurance that any investment strategy will be successful.**

The first step is to define goals. Goals are very individual and vary widely, but typically include retirement, college education, charitable gifting, real estate purchases, and estate planning. Only by setting our sights on the future can we determine what may be achievable, and design an appropriate blueprint to follow in an effort to achieve one's desired destination. Starting with the ends in mind puts the investment planning process in motion.

Case study #1:*

Close-up on the goal of funding college and a vacation home

Let's assume the following:

- A couple is in their early 50s with an eye on retiring at age 65
- College tuition savings is there for their daughter, with college starting in two years
- They would like to buy a vacation home in four years
- Assets include a joint taxable investment account, two IRAs, and equity in their home

Assuming their future lifestyle remains as it is today, would the couple be able to achieve their goals? What, if anything, might need to change or be considered to enhance the likelihood of those goals being fulfilled? The analysis requires a grasp of the client's complete financial picture, which includes the following key considerations:

Cash flows. Gathering information around income and expenses sounds to many like creating a budget, but it involves far more. Building out a personalized income statement and providing insight around cash inflows and outflows brings the investment planning discussion into focus. For example, with college on the horizon and a house purchase not that far away, understanding current and expected future expenses helps inform how they should invest. Let's assume the couple's daughter wants to attend an expensive private school. That would require substantial additional outflows and it indicates the need to keep more funds available and out of risk assets (where the return is uncertain) over the short term in order to fund those expenses. In essence, it tells us a portfolio's asset allocation should probably be more conservative than if the money wasn't going to be needed until later.

Although retirement is at least 10 years away, the assets focused on saving toward that goal—based on the potential house and college expenses—could be roughly what they had originally projected them to be based on the type of house they purchase or finance, along with the potential college costs.

* The case studies in this paper do not represent actual clients. They are used to illustrate how Paragon can be used to analyze certain fact patterns.

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Although the investments should most likely be slotted for growth with over a 10-year time horizon, the amount they may need in the meantime for these extra expenses needs to be considered. This has the potential to alter the asset allocation and portfolio risk needed to achieve a goal of retiring at age 65. Without understanding the cash flows along with the goals, investment allocation becomes a guessing game. A simple cash flow analysis as part of the investment plan gives us the framework to create the correct investment portfolio.

Balance sheet. Also known as the net worth statement, the balance sheet (assessment of assets vs. liabilities) is one of if not *the* most important piece of the wealth management puzzle. Any debt currently on their balance sheet could impact decision making around an investment strategy that is most likely to fund their desired goals. Here, we know they have equity in their home and various marketable securities investments—but if they are carrying a significant mortgage on their first residence, this could affect the amount they need to set aside for both college and for the purchase of a second home. Contrarily, if they own their home outright, it could provide the ability to use their house and/or investments as collateral for financing future purchases.

In Case #1, the couple has many assets without meaningful liabilities. Here are a few potential means of approaching the house purchase which Paragon can compare and lend insight into which might be most appropriate:

1. **Purchasing outright with funds freed up by redeeming portfolio assets** comes with significant tax consequences. The amount to purchase would require a substantial capital gain (both federal and state) in that tax year. This would have a detrimental effect on their future assets as they miss out on the compound interest over time.
2. **Borrowing against the equity in their current house,** with a home equity line of credit (HELOC). Although the interest rate will fluctuate based on the Secured Overnight Financing Rate (SOFR), the interest will mostly be offset by future earnings in their assets.
3. **Using assets as collateral for a loan,** with a securities-based line of credit (SBL). Their current portfolio might allow for an adequate amount to fund at least a portion of the purchase. This interest rate they would pay would be more/less than the HELOC based on the risk associated with the collateral.

The conclusion was to utilize tax losses in the portfolio along with the HELOC/SBL to achieve the best result. This process can be used for any type of borrowing, including private business loans, airplanes, and yacht purchases. Each type of loan brings about unique planning challenges and should be evaluated through the investment planning process.

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Risk tolerance discovery

How much risk are you able or willing to take with your portfolio? Some individuals are very comfortable with volatility and take it as an expected part of investing. Others suffer sleepless nights when markets shake, rattle, and roll. To help guide the risk discussion, an advisor will ask about your time horizon, age, and other factors. A risk-based questionnaire can also help determine how you perceive risk and help gauge the emotional response to potential scenarios. Although all of these are effective, we find that building out an investment plan is the most effective way to accomplish gauging risk tolerance.

How we define risk: the lowdown on drawdown

Although risk is traditionally measured by standard deviation (the probabilities of upward and downward moves in the portfolio) we find that individuals are primarily focused on downside or, as we say, "drawdown"—a peak-to-trough drop in asset values. Drawdown provides a glimpse into what can happen at some point during the lifetime of the portfolio. When the markets become volatile, we find it wiser to enter those situations with an enhanced understanding of what is likely to take place and the potential outcome. Let's see two examples of risk analysis in action, applied to the goal of retirement.

Case studies #2 and #3:

Close-up on financing or purchasing outright a retirement home

Some individuals are concerned about the possibility of outliving their money. Pairing this comparative analysis along with historical risk statistics provides detailed knowledge of the potential downside associated with each potential portfolio. This in turn allows the client to make an educated decision around their risk tolerance.

For example, let's assume Client A is a couple planning on retiring in five years who want to buy a $2 million home for their retirement. They would rather not take on additional debt to finance the purchase. In applying this scenario to their investment plan, we make the following assumptions:

- The funds for the home would come directly out of savings ($400,000 in cash) and their portfolio ($1.6 million, by liquidating securities)
- Their current lifestyle will be funded in retirement through their portfolio, IRA distributions, and Social Security; annual expenses are $300,000 (adjusted for inflation going forward) and they would like to maintain their lifestyle throughout retirement

We determined that their current asset allocation would not adequately support their lifestyle at those spending levels and our calculations show they have less than 50% chance of achieving their goals. However, if they were to assume a greater risk tolerance, the likelihood of achieving their goals rises, which would be acceptable to them. Unfortunately, that higher risk tolerance comes with a higher degree of drawdown. The potential for that loss within the lifetime of the portfolio is just too much for them to bear, so other options will need to be explored.

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Now, let's take the case of Client B, with ample assets to last beyond their lifetimes to fund a legacy. Using a similar analysis as with Client A, we helped paint a picture of portfolio risk and unintended results. Client B is a three-generation family. Generation 1 is a couple who created the wealth through a business they started many years ago; Generation 2 includes two married daughters; and Generation 3 consists of six grandchildren. Generation 1 has always been very philanthropic, has given generously across their lifetimes, and would like to plan for sizable donations at their passing.

Although they have set up trusts for their children and grandchildren using both their lifetime exemptions (currently $23.4 million for the couple), there is still great wealth beyond those assets to support their lifestyle and gifting. They have maintained a similar asset allocation across all of their various accounts, but Paragon helped reveal that approach may not be the most effective means of reaching those goals. When we run an analysis on the assets outside the trusts, we can project their growth over the remainder of the couple's lifetimes. However, as they had not intended to leave that much money to charity or family and were inclined to reduce estate taxes where possible, the ensuing conversation focused on how to create a foundation, make additional gifts to family, and other ways to benefit their family and community.

Investment assets: location, location, location

The number one rule in real estate—location, location, location—is just as apt when it comes to the many investment accounts and vehicles or trusts in which one's wealth may be held. Each of these locations, or "buckets," in a portfolio is unique, possessing specific considerations, advantages, or even limitations. However, where one might look at these buckets and see the differences or challenges, Paragon can shine a light on opportunities.

Case study #4:

The very model of a modern multigenerational family

A business owner and her spouse, both 60 years old, created several entities to take advantage of the lifetime gift exemption for estate planning purposes (currently $24.12 million for a married couple). Yet, despite the various entities—and before the business was sold—they viewed their cumulative wealth through the same lens, with all the funds invested conservatively to offset concentrated business risk. After the business was sold, however, with assets totaling about $150 million, they maintained the same conservative risk tolerance and investment strategy across the entire portfolio.

Enter Paragon. With our proprietary software, we were able to look at each bucket and determine what made sense for that particular entity based on asset location. Paragon also revealed the risk associated with all assets across the board, which permitted the couple to have a more comprehensive understanding of the potential for drawdown. Since the liquidity event, all the portfolio buckets are in an overarching "conservative" (income-oriented) portfolio of approximately 26% equity/68% fixed income/3% inflation hedge/2% cash.

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Asset	Investment plan post Paragon
Cash management account, with $5mn was held aside post transaction for a potential real estate purchase within 12 months	With a potentially too-risky drawdown, an account with all short-term, highly liquid fixed income and money markets was deemed a better fit for this portfolio
2 revocable trusts, each ~$10mn, used for annual expenses of ~$1mn, to sustain the couple's lifestyle	Analysis projected that a conservative asset allocation should meet this need going forward
IRAs rolled over from former 401(k)s held at her company/his employer, with ~$3.5mn and ~$1.5mn, respectively	With required minimum distributions (RMDs) to begin in 12 years, allowing them to maximize their wealth on a tax-deferred basis during that time while maintaining a growth mindset made the most sense
Irrevocable life insurance trust (ILIT), funded with $5mn as part of their estate plan to help fund potential future estate taxes	To fund the premiums, a moderate growth allocation's total return—growth of assets and income generated—while considering potential drawdowns, would likely cover the premiums without requiring added capital
Spousal lifetime access trust (SLAT) for each spouse, set up with pre-liquidity stock, each holding ~$12.5mn post transaction	Assets are slated to grow for the benefit of each spouse and future generations; it is unlikely the assets will be needed for future spending, given the size of the revocable trust; a growth-minded allocation with private markets* made sense given the length the assets would be invested and the time-line for the funds to be distributed to future heirs
An irrevocable trust for each child (ages 33, 30, 28, and 26), funded with pre-liquidity company stock and designed to benefit the children and their families over their life-times, with one-third distributions to be made at ages 35, 40, and 50	Based on the ages of each of the children and the investment planning process, the asset allocations were determined to be either aggressive or growth-minded depending on their situation. Private markets needed to be considered on a case-by-case basis given the potential for upcoming distributions.
Family LLC, structured to live in perpetuity and funded with pre-liquidity stock—currently with $50mn in cash—is intended to act as a vehicle that grows and manages wealth for future generations; each family member will become a member of the LLC and receive dividends over their lifetimes	The investment plan sees a growth markets allocation as ideal for this scenario, and allows for private markets—which will not detract from liquidity needed for future dividends and will also help add potential return; the fixed income portion of the portfolio will help support borrow-ing capacity (as the LLC was designed to use the assets as collateral for borrowing purposes), while also serving to manage volatility and enhance diversification
Family foundation funded with post-liquidity assets, now ~$10mn	Designed to grow in perpetuity, and pay out 5% of its value each year, planning for the payout and growth would require an ongoing growth or aggressive asset allocation

When we bring all the assets together into a whole, the overall asset allocation would be considered as moderate growth. Each entity, however, requires a more unique approach as determined by its tax efficiency and/or account requirements. To invest appropriately, asset location becomes an important piece of the puzzle. Through the investment planning process, we can better understand the needs of each piece of the puzzle to better manage the entire picture.

* Private funds are available only to certain investors who meet the specific income, experience, and investable assets thresholds set forth by the U.S. Securities and Exchange Commission's definition of "accredited investors" and/or "qualified purchasers" as necessary.

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The output of Paragon—what you can expect

A Wilmington Trust advisor will review and interpret the results of Paragon's analysis to help engineer your customized portfolio—one that is aligned to your specific risk tolerance, time horizons, and financial objectives. You will receive the details of your financial picture, including tailored, flexible reports generated on current and proposed portfolio allocations, wealth projections, cash flow projections, historical risk analysis, and a host of other analytical data so you can easily see how it all fits in the context of your portfolio and objectives.

These materials will enable your advisor to illustrate how a hypothetical portfolio may perform against key benchmarks as well as the potential risk and return effects of making proposed adjustments in the event of a major life event, such as a change in income or marital status. You will see at a glance the various allocations built from your input through a methodology that accounts for relevant variables, such as taxes, turnover, capital markets assumptions, and asset class constraints.

Next steps

Is your portfolio on track to meet the full breadth of your wealth management goals? A customized, optimized portfolio is at the crux of your integrated investment plan, which sets the stage for overall wealth planning. To see how Paragon's complex analytics might help you achieve your objectives, contact a Wilmington Trust advisor.

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Paragon is a portfolio analysis, risk assessment, and goal optimization tool. The Paragon report uses hypothetical examples in conjunction with forecasts for inflation, economic growth, and asset class returns, volatility, and correlation and provides you with general financial planning information to serve as one tool in helping you develop a strategy for pursuing your financial goals. It is not intended to provide specific legal, investment, accounting, tax or other professional advice. For specific advice on these aspects of your investments, you should consult your professional advisors. Paragon report returns are not guarantees of future results. There are serious limitations to hypothetical results and methodologies used to obtain the Paragon results. Actual market conditions affecting, and performance results for, any portfolio shown herein will likely vary, possibly significantly, from any hypothetical results shown.

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