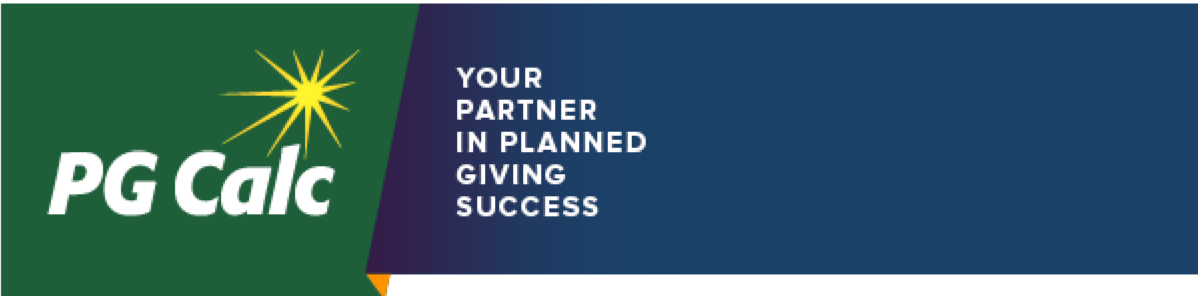

Now That the Dust Has Settled (Investments and Life Income Gifts After 2018)

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By Jeffrey Frye, Senior Client Services Advisor, PG Calc

You can't say they hadn't warned us. For years, the experts had cautioned that stocks were severely over-valued, and that a major reversal was coming. We had ended the previous 9 calendar years – 2009 through 2017 – with positive returns on stocks. We were enjoying one of the longest bull markets in history. Surely, we knew it couldn't last forever, right? And in the first 3 quarters of 2018, stocks kept going higher and higher, to record levels. But then, in the 4th quarter of 2018, everything suddenly changed. The S&P 500, the Dow Jones Industrial Average, and the NASDAQ started crashing. Maybe some would say that's an overstatement, but in general terms, there was a dramatic correction; the S&P came within a few percentage points of the dreaded 20% decline that marks entry into a bear market. And we ended the year of 2018 on a negative return, for the first time since 2008.

Impact on Planned Giving

What did that mean for various planned giving vehicles, and for planned giving programs in general? More specifically, what did it mean for the life income gift arrangements that make up such a large proportion of many planned giving programs? Were the good times truly over? Should everyone stop writing gift annuities because the stock market experienced significant decline for a change? Did the results of 2018 prove that you can't trust the stock market, and that all money should be held in bonds or cash or hidden under the proverbial mattress? Perhaps we should take pause and reflect; rather than succumbing to a knee-jerk reaction, maybe we should take a closer look at the recent history of stocks – and bonds – and put the experience in perspective.

Here's the thing - I am not an investment professional, I am a planned giving advisor. I work with non-profit organizations and their financial institution partners to help develop and manage planned giving programs. But I did spend a number of years as a portfolio

manager, and I have sat at the table participating in discussions about the investment management of planned giving assets for the past 30 years. I have worked with hundreds of planned giving programs over the years, and most of them have been very successful. *My measure for success is that the split-interest charitable gift arrangements provide substantial benefit to both the donors and the charities.* As long as reasonable gift plans are put into effect, and as long as prudent measures are taken to manage these arrangements, there is no reason for these vehicles to disappoint either side of the equation.

I worked during the recession of the early 90's and through the dot-com buildup of the later 90's. I worked during the dot-com collapse / recession in the early 2000's and through the frantic buildup of the financial markets in the following years. Healthy planned giving programs survived all of those periods of time. Yes, some years were more rewarding for donors, and some years were more prosperous for charities, but in the long run, the familiar concepts of split-interest charitable gift arrangements proved their merit.

The Great Recession and Long-Term Risk

Since the collapse of the financial markets in 2008, however, and the ensuing Great Recession, I have seen greater anxiety over the general viability of planned giving programs than I saw in the two previous decades combined. Indeed, there is reason for concern – we had the second worst year in stock market history in 2008. The losses in portfolio values, both personal and institutional, were absolutely mind-boggling. Watching investment portfolios take 20 – 30% hits in one calendar year is enough to frighten even the most confident of investors. And when it's part of a fiduciary relationship, the consequences are even more painful.

I can also offer some general observations: internally, the governing boards of non-profit institutions have grown more and more concerned about the risks of long-term investment of assets. The professionals in the finance and business areas are increasingly badgered by new waves of auditors with ever-more-conservative life expectancy estimates. *Donors who establish life income gifts arrangements always live longer, right?* Various state regulations regarding the reserves for gift annuity assets have become more and more restrictive. And then there are always the other voices – the donor constituencies questioning investment policies; well-meaning but inexperienced consultants pointing out all the potential pitfalls; and general hysteria in the community over the perils of the financial markets.

Renewed Concern

Which brings us back to 2018 – actually not a dramatically bad year, in light of history. The major U.S. stock indices were down 3 to 6%. But that was bad enough to set off a whole new bunch of nervous conversations. Gift annuity programs are surely being questioned yet again – especially those with deferred and flexible deferred options. I hear the comments now: "*Are we sure about issuing these charitable gift annuities?*

We'd better start talking about capping those long-term payout rates at 10% or we're going to go belly-up!"

The Facts

In light of all that, I wanted to offer some actual long-term results; to provide a substantive fact set as a possible counter to anxiety and panic. We have the numbers in black-and-white – *it is public information* – to make the case for planned giving in general and for life income gift arrangements in particular. *The logic is not complicated – it's really quite simple: Establish sensible gift plans and manage them prudently over the long run. There will be exceptions – there are always outliers – but overall, the concepts will prove successful.*

Positive Indices

The real world of investing long-term assets is more complicated, but we only need a couple of well-known and broadly-quoted indices to make our case. The Standard and Poor's 500 Index gives us reasonable estimates for returns from stock investments, and the Barclay's Aggregate Bond Index gives us reasonable numbers for bond investments. If we look at the 25 years from 1994 to 2018, each index has considerable variability, but there are similarities to be found.

Year	Barclays Aggregate	S&P 500
1994	-2.92%	1.32%
1995	18.46%	37.58%
1996	3.64%	22.96%
1997	9.64%	33.36%
1998	8.70%	28.58%
1999	-0.82%	21.04%
2000	11.63%	-9.11%
2001	8.43%	-11.89%
2002	10.26%	-22.10%
2003	4.10%	28.68%
2004	4.34%	10.88%
2005	2.43%	4.91%
2006	4.33%	15.79%
2007	6.97%	5.49%

2008	5.24%	-37.00%
2009	5.93%	26.46%
2010	6.54%	15.06%
2011	7.84%	2.11%
2012	4.22%	16.00%
2013	-2.02%	32.39%
2014	5.97%	13.46%
2015	0.55%	1.25%
2016	2.65%	12.00%
2017	3.54%	21.70%
2018	0.01%	-6.24%

Source: Barclays, Standard & Poor's (price only).

In general, we can see that in the long run, both stocks and bonds appear to produce positive results. The results of stocks vary more widely – higher positives and lower negatives – but the trend lines are similar. The standard fiduciary investment portfolio is a combination of stocks and bonds (or the mutual-fund equivalents of each). Taking these results in the simplest format, if we assume 50% stocks and 50% bonds over those 25 years, we come up with the blended investment return numbers for those same years:

Year	Barclays Aggregate	S&P 500	Blended
1994	-2.92%	1.32%	**-0.80%**
1995	18.46%	37.58%	**28.02%**
1996	3.64%	22.96%	**13.30%**
1997	9.64%	33.36%	**21.50%**
1998	8.70%	28.58%	**18.64%**
1999	-0.82%	21.04%	**10.11%**
2000	11.63%	-9.11%	**1.26%**
2001	8.43%	-11.89%	**-1.73%**
2002	10.26%	-22.10%	**-5.92%**
2003	4.10%	28.68%	**16.39%**
2004	4.34%	10.88%	**7.61%**

2005	2.43%	4.91%	**3.67%**
2006	4.33%	15.79%	**10.06%**
2007	6.97%	5.49%	**6.23%**
2008	5.24%	-37.00%	**-15.88%**
2009	5.93%	26.46%	**16.20%**
2010	6.54%	15.06%	**10.80%**
2011	7.84%	2.11%	**4.98%**
2012	4.22%	16.00%	**10.11%**
2013	-2.02%	32.39%	**15.19%**
2014	5.97%	13.46%	**9.72%**
2015	0.55%	1.25%	**0.90%**
2016	2.65%	12.00%	**7.33%**
2017	3.54%	21.70%	**12.62%**
2018	0.01%	-6.24%	**-3.12%**

This is very basic information – these are some of the most broadly-quoted indices for stocks and bonds – but putting the information together in this way makes for a powerful message. When asset managers take a thoughtful approach to investing over the long run, creating an investment portfolio with a healthy mix of stocks and bonds (or the equivalents thereof), the results are distinctly reassuring. With the combined investment posture, most of the years are positive, and several are very positive. There are only a few bad years, and only one really bad year (2008). Of course, there is an old adage in the world of investments – past performance is no guarantee of future results. There are no absolute guarantees. But let's take a further look at how these numbers play out over time.

The Bottom Line

Any one year can always be a blip – an exception – but computing the averages over a longer period of time gives us further confirmation of the power of long-term investing. Here is the most important comment in this post:

The average return for the hypothetical portfolio consisting of 50% bonds and 50% stocks, for the 25 years beginning in 1994 and ending in 2018 is 7.89%.

I feel like that is such an important statement it should be repeated and put in bold print:

The average return for the hypothetical investment portfolio consisting of 50% bonds and 50% stocks, for the 25 years beginning in 1994 and ending in 2018, is 7.89%.

That is quite impressive, because the time span includes two of the worst years in stock performance since the Great Depression – 2002 with a return of -22.10%, and 2008 with a return of -37.00%! Given all the variance in the results of stocks and bonds over the past 25 years, a hypothetical portfolio of 50% stocks and 50% bonds produces an annual return of almost 8%. And that, in reality, is a bit on the conservative side. Most fiduciary asset managers push the equity component over 50% - it's typical to see a 55% or 60% portion of a fiduciary portfolio in stocks. That would make the long-term averages even higher.

While these numbers are solid and impressive, we should acknowledge that not all gift arrangements run for 25 years. In fact, that is a bit on the long side. There isn't a lot of statistical information, but anecdotally, I would venture to say that most gift plans run for somewhere between 10 and 20 years. What do the long-term averages look like for other increments of time? If we compute only the last 10 years ending in 2018, we get an average return of 8.47%. So that's even a little better. But it doesn't always go that way.

If we take the last 15 years ending in 2018, we get an average of 6.43%, and if we take the last 20 years ending in 2018, we get an even lower average of 5.83%. Those are important numbers to keep in mind, but they are all comfortably above the standard 5% payout rate of most charitable remainder trusts being written over the past 10 years. If the payout rate on a CRT is 5%, and the expense (fee) ratio is 75 basis points, the principal value is still going up slightly over time. And if a gift annuity is paying 6%, there will only be a very small erosion of principal over time; the remainder of the corpus should still be well above 50% of the original funding principal amount (the goal established by the American Council on Gift Annuities when setting recommended payout rates).

Conclusion

This all brings us back to the main point of this post: there is no need to fear the investment side of planned giving, even with the disappointing results of 2018. We had one bad year after a string of 9 consecutive good years. And we've only had 2 truly bad years over the past 25 years. Moreover, the stock market has been generally up in the months since the beginning of 2019; in fact, at this time, many fiduciary portfolios have recovered much, if not all, of their losses from 2018.

Planned giving programs don't need exotic investments or overly-complicated strategies, and it shouldn't be a problem when donors live well beyond their theoretical life expectancies; *if a program is run well, there should be plenty of cushion based on the strength of the investment assets and their performance*. Over the long run, the thoughtful investment of fiduciary portfolios, with the right mix of high-quality stocks and

bonds, should produce results that ensure the general strength and viability of planned giving programs. Those programs that start with sensible funding amounts, appropriate payout rates, and a prudent investor approach, will be successful despite the many ups and downs of the stock market.

I hope you found this post helpful. Please feel free to contact me if you have any questions or would like to discuss further.