SPECTRUM

A newsletter for the friends and clients of First Republic Private Wealth Management

Volume 46 Winter 2020

Cashing Out Your Stock From an IPO

Nine Important Steps to Take Before Deciding

Rich Scarpelli, Head of Financial Planning,
First Republic Investment Management

Though there is no shortage of market volatility these days, IPOs have been making headlines with billions of dollars raised in one of the most active years in the past decade. If your company goes public, knowing what to do with your slice of the pie can feel overwhelming. Here's a brief guide for your post-IPO financial life and making the most of a possible liquidity event.

DETERMINE WHAT PRECISELY YOU OWN

Now that the rubber has hit the public offering road, the details of what is in your portfolio will no doubt begin to take on considerably more weight and urgency. If, for example, you have restricted stock or restricted stock units (RSUs) — i.e., shares or units that typically vest over time based on your length of employment or certain performance benchmarks — the IPO may very well be the trigger to finding out what you actually own. Which means you are not only close to knowing the actual size and shape of your potential windfall, but also to having to grapple with the accompanying personal finance, tax and regulatory implications.

As far as employee stock options, which are a set number of shares an employee is allowed to purchase at a specific price over a set period of time

Rich Scarpelli, ChFC®, Head of Financial Planning, First Republic Investment Management

CASHING OUT YOUR STOCK FROM AN IPO

Continued from cover

according to a vesting schedule, are concerned, a whole host of issues are at play. Among these are when you should exercise (i.e., pre- or post-IPO), whether your grant is an incentive stock option (ISO) or non-qualified stock option (NQSO), do you have the liquidity to purchase the shares and cover the income tax, and your investing time horizon and risk tolerance level.

USE DELAYS TO INFORM DECISION-MAKING

When a company goes public, there is a lock-up period — typically around 180 days — that prevents an employee from selling their stock. And for good reason: Without one, overly exuberant insiders could sell a plethora of shares immediately after IPO, distorting — and, perhaps, depressing — the stock price just as general investors are getting their first crack at it.

Of course, this can be a nerve-racking time for employees such as yourself who are essentially asked to sit by and watch any price fluctuations without recourse. On the other hand, one can also look at this as an opportunity to digest the IPO, the market and public reaction to it, and consult with seasoned advisors about best next steps to take once the dust settles.

> How can you best integrate your post-IPO stock into a properly diversified portfolio that will serve your short- and long-term goals?

What, for example, are the pros and cons of selling immediately after the lock-up period versus selling on a predetermined schedule — say, a certain percentage each quarter to hedge against potential volatility? How can you best integrate your post-IPO stock into a properly diversified portfolio that will serve your short- and long-term goals? What context might you be missing regarding both the potential upside and downside of the stock by virtue of your emotional and financial proximity to it?

The answers to all of these questions will likely be easier to find with an outside, experienced perspective on hand.

DEVELOP AN INVESTMENT STRATEGY

Your goal in the immediate aftermath of an IPO is, somewhat paradoxically, simple but not easy. Essentially, you'll want to integrate the pros and cons of the aforementioned acronyms — RSUs, ISOs and NQSOs — into your own slate of resources, needs, and short- and long-term goals. That may mean accepting the tax exposure of an immediate payout in order to pay down high-interest debt.

Or, conversely, holding stock for long enough — a year — to transform what would've been classified as a short-term hold and taxable as ordinary income to the typically lower long-term capital gain rate. A financial advisor can help you more fully understand your menu of options and tailor your strategy accordingly.

DON'T LET LAX TAX PLANNING REDUCE YOUR BOUNTY

If you think you're happy about your windfall, imagine how Uncle Sam feels: After all, depending on the amount of money you net from an RSU vesting or stock option, you could land in a higher personal tax bracket, facing an increased alternative minimum tax or calculating new capital gains tax exposure. And then there's state and possibly local tax liabilities as well.

The key here is to understand the nuances. In the case of an NQSO, for example, your tax exposure is determined as soon as you exercise the option — i.e., your standard income tax rate on the difference between the exercise price and current fair-market rate — with capital gains coming in after you sell if you held on to any shares after exercise and there was further appreciation.

Meanwhile, an ISO, as its name suggests, has greater complexity and is potentially more favorable from an income tax perspective. Although, even under this scenario — as noted above — *when* you sell can have a substantial impact on the size of the check you'll have to send to the government and the alternative minimum tax will have to be evaluated.

There are also a couple of tax elections under IRC Section 83 you may be able to make that convert potential future ordinary income to capital gain or defer the payment of taxes. Additional tax incentives may also help manage and mitigate your capital gain exposure by taking advantage of Qualified Small Business Stock treatment if certain criteria are met. A CPA and/or tax advisor well versed in these areas can offer often priceless insight and advice.

> One of the greatest gifts you can give your loved ones is a peace of mind during an extraordinarily difficult time.

THINK BEFORE YOU SPEND

A lot of temptation to shift money around is to be expected. Depending on the size of it, you may simply get a little too casual with your spending or, further up the mountain, begin to have visions of sleek boats, fancy cars and budget-stretching houses dancing in your head. The best way to counter this? *Know thy financial self.* Prioritize. Visualize. Consult experts. Plan. Budget. And you'll be much less likely to get off track.

BE WARY OF 100% CASH PURCHASES

Yes, you should be living within your means. No, you shouldn't be carrying credit card balances chock-full of impulse purchases. That said, when it comes to medium to large outlays, just because you *can* pay in all cash doesn't necessarily mean you *should*.

Pro tip: Work with your financial advisor to come up with the best plan of action that takes into account your unique financial situation.

CREATE AN ESTATE PLAN

One of the greatest gifts you can give your loved ones is a peace of mind during an extraordinarily difficult time. If you don't have a will, a financial windfall can serve as a great prompt to put your wishes down in writing, create a legacy on your own terms and ensure the distribution of your assets — both financial and personal — is as smooth and painless as possible should the unexpected happen.

EVALUATE NEW INVESTMENT OPPORTUNITIES CAREFULLY

It's worth noting, too, that those who peddle risky investment schemes have an extraordinarily good nose for "new" money. While there is a time for embracing bold and exciting investment opportunities, vet your potential partners well. Also, if you choose to launch a new business, avoid financing it entirely with your new windfall. As always, a good rule of thumb is to believe in yourself but be mindful of placing all your eggs in one basket.

ENJOY THE FRUIT

Remember, this is part of the compensation for all your hard work. Honor it as such, and it is more likely to be enduring rather than fleeting.

Jeff Kuhlman, CFA, Vice President–Research,
First Republic Investment Management

Can Signing an Investment Policy Statement Make You a Happier Investor?

Following a Consistent Plan to Avoid Constant Decision-Making

> The IPS is an investment plan that connects your human and financial capital to your goals.

Imagine it's two weeks before Election Day and you receive a call from someone conducting a survey who asks you how likely you are to turn out and vote. How would you respond? Most citizens would want to appear to respect their civic duty to vote and would indicate to the caller a high likelihood of voting on Election Day. Does this affirmative response lead to a higher probability of that person actually voting? Yes, according to a study by social psychologist Robert Cialdini highlighted in his book *Influence*.

These citizens made a commitment to vote, and it's human nature to behave in a manner that's consistent with one's commitments. Consistent behavior is a way for people to signal stability and rationality. Consistency also provides a mental shortcut for dealing with life's complexities.

Investors make a similar commitment when they sign their investment policy statement (IPS). The IPS is a long-term road map for meeting your financial objectives while also capturing your risk tolerance and personal preferences (e.g., sustainable and responsible investing guidelines). Said another way, the IPS is an investment plan that connects your human and financial capital to your goals.

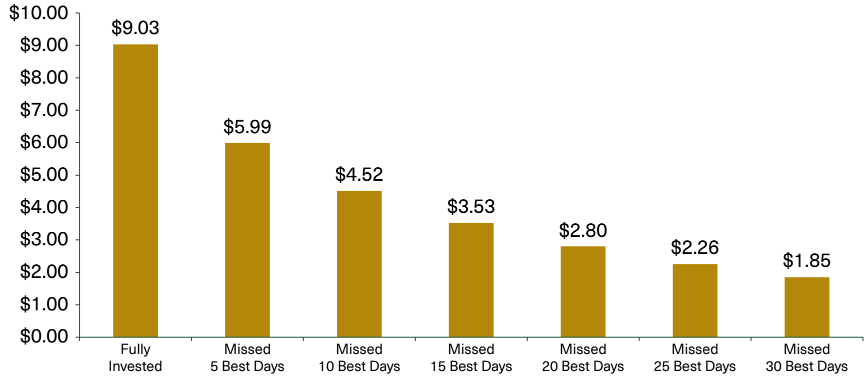
CONSISTENCY IN INVESTMENT

Signing the IPS is designed to promote a consistent investment approach rather than a whimsical one that may lead to irrational decision-making such as market timing. Market timing may cause inferior returns relative to other trading strategies. By avoiding market timing, we believe investors improve the return potential of their portfolio, increasing the likelihood of achieving their financial goals. The following chart illustrates the risk of timing the market. Missing best-performing days in the market over the course of 30 years can add up.

Investors are constantly bombarded with news about the markets and geopolitics. This news can make people feel like they need to constantly make

Market Timing: Impact of Missing Best-Performing Days

Growth of $1 invested in the S&P 500 for 30 years ending on 6/28/19



Source: Crandall Pierce

decisions about their investment portfolio, and too many decisions can lead to anxiety and stress.

SYSTEMATIZE YOUR DECISIONS

An IPS helps systematize many of these decisions. For example, the IPS says rebalancing the portfolio will occur annually or when the allocation to stocks moves outside of a stated range. While this type of discipline may seem mundane, it reduces the mental energy associated with constantly wondering what to do with your portfolio. A parallel could be drawn to the way Barack Obama and Mark Zuckerberg approach their wardrobes. Both have acknowledged that they wear the same thing every day in order to save their mental energy for other decisions.

Harvard psychologist Daniel Gilbert provides a good example of how reducing decisions can lead to greater satisfaction. In his TED talk "The Surprising Science of Happiness," he describes how a class of photography students was divided into two groups — the first got to choose one of their pictures to keep and couldn't return later to swap it out, and the second got to choose one of their pictures to keep and had up to four days to switch it out for another picture. The group that had to commit to a picture (no returns allowed) had greater satisfaction with their choice than the group with the option to return their photo.

Psychologist Barry Schwartz notes in his TED talk that "regret subtracts from the satisfaction you get out of the decision you made, even if it was a good decision." This is not to suggest that there aren't important decisions associated with one's investment portfolio. Major changes in one's circumstances or goals should trigger decisions that would be updated and captured in the IPS. However, decisions associated with market movements and portfolio management are addressed in the IPS and shouldn't require constant decision-making.

The IPS sets forth guidelines by which to invest. Committing to these guidelines reduces the amount of decisions one has to make on a daily basis, may promote greater satisfaction and, we feel, supports better investor outcomes. If you are interested in learning more, our team of professionals is at your service and looks forward to discussing your financial goals.

Major changes in one's circumstances or goals should trigger decisions that would be updated and captured in the IPS.

Kelly Arrillaga, CTFA, Senior Trust and Fiduciary Advisor, First Republic Trust Company

Anna Howard, Family Wealth Leader, First Republic Investment Management

You Can't Always Get What You Want

Talking With Children About Wealth and Entitlement

Many wealth management clients often encounter the same issue — they want to know how to prevent their children from becoming entitled. Specifically, they're concerned that their children will rely on family wealth instead of forging their own paths to success and will lack an understanding of money beyond how to spend it.

Parents can become resentful because they're already witnessing entitlement in their children. We've talked to parents who are hurt and confused because they thought they were creating self-sufficiency, but their children are behaving in the opposite manner. Moreover, parents may inadvertently seed entitlement in their children even as they're trying to avoid it.

These experiences and concerns are so prevalent that we decided to research the topic further, consulting with therapists, a parenting coach and an early education specialist. Below are five consistently identified principles to help parents create more self-reliant children and sidestep the entitlement trap. The most encouraging takeaway: It's never too late to start this work with your children.

REWARDS THAT AREN'T MATERIAL

Nearly every parent encounters a time when they use extrinsic rewards to make a child feel better or to incentivize them. Conversely, we all have things that we'd like to have, whether it's a nice car, a bigger home or a beautiful piece of jewelry. However, as Madeline Levine says in *The Price of Privilege,* "We don't necessarily contribute to our children's emotional problems when we buy them cars or expensive clothes or high-end vacations; we contribute when they believe by observing our behavior or our values that these are the things that matter most in life."

Material things aren't the root source of the entitled behavior. Instead, they facilitate the false belief that getting something will make us feel a certain way — important, accomplished, respected, validated. When things replace authentic emotion and connection, children can easily prioritize the material reward over the value of what they've done. Finding ways to validate your child and build their self-esteem without using material items helps build confidence.

For instance, if your child worked hard all semester to earn excellent grades, then an appropriate reward might be spending a day off with you. The child worked hard, and now he or she gets to relax, have fun and hear from you how much you appreciate their work and dedication. The reward isn't necessarily material, and the focus is on your child's effort and commitment.

CONNECTING MONEY AND VALUES

Money and values are closely related. For many parents, money represents hard work, responsibility, achievement and smart decisions. Part of helping children understand the value that money represents is simply talking about it. Openly discuss what you see as the value of money and the reasons for your spending choices. Such conversations help your child respect money management rather than assume that having money is about "getting stuff." These can be ongoing discussions, and your insights here are precious. For example, consider sharing with your child a time in which you purchased something that you thought would make you happy, only to realize that a fancy watch or expensive pair of shoes didn't offer that much fulfillment.

As a bonus, the prospect of a spending discussion may prompt you to understand your values better. Spend time with your partner to discuss the values that truly define your family; some examples are work ethic, self-sufficiency, kindness and empathy. Come up with five that resonate and put them in writing. Then talk about what these values mean to you, the experiences you've had that informed them and what you want for your children. These are meaningful conversations, and you'll come away with a framework for evaluating your family's spending habits.

If your child makes a financial request of you, then these same values provide a touchstone for your answer. As the parent, you can refer to what you've discussed and determine whether your child's ask fits within your family values — or is well outside. For instance, perhaps your child regularly wants money to make daily purchases within an app. If your family values include responsibility and prioritizing tangible goods over virtual items, then you can say so. Creating this essential financial foundation makes it easy to make consistent decisions around financial contributions to your children — and helps redirect entitled behavior toward a more productive end.

If you find a mismatch between your family values and your child's assumptions, address it.

OPENING LINES OF COMMUNICATION

Creating an open dialogue around money also helps build understanding in your children about what money means — and what it doesn't mean — and how your family views its wealth. It's natural for kids to have questions about how much you make or how much money you have. Before you answer, ask what makes them wonder. You might uncover some underlying assumptions that your child has about your family's wealth or status.

Often, you may find that your child's ideas can be far from your version of reality. You may even be baffled about how they arrived at a given conclusion. Refrain from judgment and focus on creating a collaborative dialogue around these issues. If you find a mismatch between your family values and your child's assumptions, address it. You may also encounter an opportunity to examine your own unspoken behavior around money — messages you may have unintentionally sent. These honest interactions are all part of the learning process, and they can happen at any age, whether your children are in preschool or adults.

Continued on page 8

Continued from page 7

You've accumulated your wealth based on your hard work and financial decisions. Having ongoing conversations about what you gained from your experiences, what you've learned about money and challenges you've overcome provides context to your values and deepens your children's respect for them.

THE STRUGGLE IS REAL (AND OFTEN IT'S GOOD)

Sometimes parents who have worked hard, made sacrifices and struggled to create their wealth want to protect their children from experiencing negative challenges. If you have the means to do so, why not? It's a natural inclination for parents, but it's not always the best approach. While well-intended, jumping in to solve a child's problem or shield them from having to problem-solve themselves can imply a lack of confidence in your child's abilities to tackle their issues. They can't grow a skill without having their own experiences.

For some parents, allowing a child to struggle, try and even fail is a challenge. However, stepping back and offering emotional support during their struggle can solidify their sense of accomplishment and resiliency. These are skills that everyone needs to thrive in the adult world.

To be sure, some of your child's "struggles" may stem from wanting something that you don't want to buy. Again, this is when you can lean on your family values. Perhaps it's a new car or even, for adult children, a new home. In some cases, the thing may be wildly out of reach — maybe they want a Bentley or access to a plane. Allow your kids to voice what they want without shame. Then encourage them to think of ways they could obtain the item on their own. By doing so, you encourage their creativity and work ethic while holding the line on your financial participation. It's a great opportunity to remind them of their capability to be creative and problem solve.

> For some parents, allowing a child to struggle, try and even fail is a challenge.

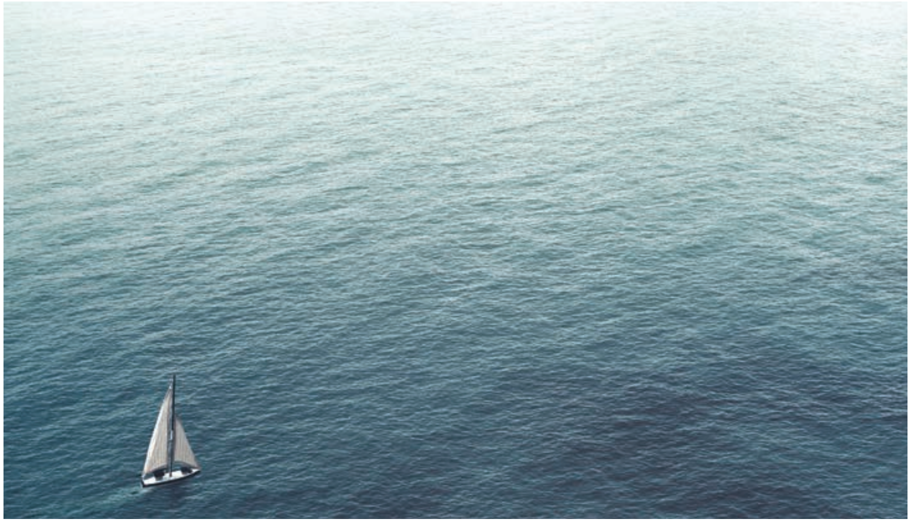
If they pursue their plan, they'll get a big confidence boost. Alternatively, your children may realize that they don't want the thing as badly as they thought, once they understand what's required to get it. The latter is invaluable for helping children become more discerning with their spending — and deciphering the connection between work, money and the things that they buy.

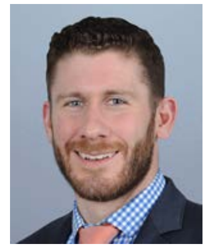
SELF-WORTH BEYOND NET WORTH

Talking about values, understanding that things don't always bring happiness, and working for what you want all contribute to helping your child to feel confident in themselves and their ability to accomplish great things on their own. The resulting experiences can propel children toward a deep level of self-worth that's independent of financial worth.

But what happens when you've done all of the above, and you remain at a crossroads? Perhaps your child is insistent about wanting something or frustrated with your lack of help. As a parent, step back and understand where your child is coming from in these moments. It's easy to assume that a child's desire for something is a direct reflection of a lack of appreciation or a desire to keep buying stuff. In reality, it is often that the child is feeling insecure in some way. They may feel judged by their peers, or they may think that shopping or presents confirms your love for them. Whatever the insecurity, identifying the source and providing reassurance are paramount.

Continued on page 11





John Frey, Senior Managing Director,
Foreign Exchange, First Republic Bank

Strategies to Help Your Business Navigate Currency Risk

Foreign Markets and Their Potential Effects at Home

As companies and high net worth individuals make international investments or take on international exposures, they are subject to the changing value of currencies. The dollar cost of running a factory in the U.K., for instance, can change dramatically as the exchange rate of the pound fluctuates — as it has recently in response to uncertainty over Brexit.

But in markets, volatility equals opportunity, and a carefully structured investment strategy with a solid risk-mitigation component at its core can help achieve a range of financial objectives.

Prepurchasing foreign currencies can provide a hedge that effectively flattens currency rates. For businesses drawing up their future investment and spending plans, this is critical to bringing predictability to the costs of overseas exposures and the value of any capital they decide to bring back home. They can also cost average their purchase over a couple of days, weeks or months.

TRADE DISPUTES AND BREXIT ROIL MARKETS

Interestingly, currency volatility has tapered off in 2019 as geopolitical tensions have caused investors to take a sit-and-wait view of the market. But those risks remain and could strike market sentiment at any time.

In London, for instance, the pound had been rallied from six-month lows after Prime Minister Boris Johnson announced he'd forged a new deal to leave the European Union. Its rally was muted as legislators rejected the plan and the country was thrust toward a general election.

However, little has unsettled global markets as much as the yearlong trade dispute between the United States and China. Leaders of both nations have traded barbs and punitive actions, interspersed with announcements of progress toward a settlement.

Foreign exchange market swings make life tricky for businesses. They may find planning difficult because treasury departments and decision-makers can't

Continued on page 10

> Little has unsettled global markets as much as the yearlong trade dispute between the United States and China.

Continued from page 9

One of the simplest strategies is known as an outright forward, which is a contract that locks in a currency's exchange rate in order to meet an obligation in the future.

predict their foreign currency obligations from one month to the next; changes in the value of a currency will result in a rise or fall in the cost or value of an asset exposed to it.

First Republic Foreign Exchange Advisors guide clients to understand these risks and manage them. They also enable clients to mitigate or reduce their overall currency exposure.

A PLAN FOR EVERYONE

A wide variety of hedging products can be utilized based on clients' risk appetite and hedging objectives. Using forwards, options, structured solutions or simply cost averaging can help manage foreign exchange risk.

One of the simplest strategies is known as an outright forward, which is a contract that locks in a currency's exchange rate in order to meet an obligation in the future. These hedging strategies are binding obligations that help reduce any currency risk associated with an exposure. Their relative simplicity makes them especially suited to startups or other companies entering international markets.

One such company, a West Coast–based biotech business advised by First Republic, needed help managing payroll and overhead costs at its manufacturing operations in Ireland. The company had monthly obligations of around €1 million, but market volatility made it difficult for the firm to predict the month-by-month dollar value of its overseas costs.

To bring predictability and accuracy to the dollar cost of those obligations, the company bought a strip of forward contracts that locked in a predetermined rate on the euro for each of the 12 months its payroll came due.

Outright forwards are binding obligations, meaning buyers won't be able to capitalize when currency markets move in their favor. In the case of the biotech firm, this was less a priority than providing a level of predictability and stability to its expenses.

In this way, First Republic Foreign Exchange Advisors act as trusted partners to treasury departments. With access to a robust number of liquidity providers and a full stack of back-testing and risk-assessment tools, clients can take advantage of risk management services that growing companies may not have access to.

SOPHISTICATED SOLUTIONS FOR COMPLEX NEEDS

Clients with more complex needs may require more sophisticated hedging strategies. For these clients, there are variations of a forward contract, or they can use currency options.

If a firm knows that a foreign currency obligation will come due but is not sure exactly when, it could utilize a window forward contract. This is a more flexible alternative to an outright forward contract because it enables the buyer to set a start and end date during which it may draw down on a fixed dollar amount at a locked-in foreign exchange rate.

For a U.S.-based nonprofit client of First Republic, this proved an effective strategy for hedging against currency risks associated with paying for an annual corporate trip to Israel. While the yearly nature of the trip was predictable, the exact timing usually was not.

To facilitate payment, the nonprofit would execute a window forward contract to buy Israeli shekels, allowing it to lock in the exchange rate for a window of time in the future.

For those clients looking for a hedge that both provides protection from adverse moves in the currency markets and is able to capture upside moves, foreign exchange options can be a good fit.

A technology company advised by First Republic implemented an FX option strategy whereby it purchased a sterling call (buy) option that placed price protection around its sterling-denominated year-end bonuses. This strategy can be viewed as placing an insurance policy around a cross-border obligation; if the market moves against a client's exposure — causing the purchase of sterling to become more expensive — the client can exercise its right to buy the currency at the more attractive level.

Foreign exchange markets can be daunting, and in tumultuous times such as these, they can prove costly to internationally exposed companies and individuals. But with the expertise of advisors such as those at First Republic, tailored strategies can offer insurance against even the wildest currency fluctuations.

YOU CAN'T ALWAYS GET WHAT YOU WANT

Continued from page 8

Consider asking some of these questions regarding your child's persistent requests:

- Why is this important to you?
- How do you think you will feel if you get this?
- What will happen if you don't get it?

As Mick Jagger said, "You can't always get what you want. But if you try sometimes, well you might find, you get what you need." You can be a source of reassurance, education and guidance for your child without giving in financially. Certainly, things can be alluring, intoxicating and momentarily fulfilling. As adults, we recognize that nice things are nice to have. However, merely handing things to your children does not build the kind of grit, understanding and savvy you want to see in them as adults.

The goal is respect for money, not reverence. You are likely to be pleasantly surprised to see what your children can accomplish on their own and delighted to see the confidence that it builds in both of you. If you have questions or need guidance, First Republic is here. We believe helping families navigate the communication around their wealth and values is the most important work we do, and we'll gladly support you on this journey.

You are likely to be pleasantly surprised to see what your children can accomplish on their own and delighted to see the confidence that it builds in both of you.

If you have questions or comments related to the topics in this issue, please contact your relationship manager.

First Republic Private Wealth Management
111 Pine Street
San Francisco, CA 94111

PRESORTED
STANDARD
US POSTAGE
PAID PERMIT #179
SAN BRUNO, CA

What to Consider When Giving Back

It's never a bad time to evaluate your charitable giving, but determining which cause and organization to support — and how — can seem like a daunting process. Please scan the QR code on the left to read our three considerations to help guide your giving choices.

To read, open the Camera app on iPhone (running iOS 11 or later). Aim your rear-facing camera so the QR code appears on the screen in the Camera app. Your device will show a notification at the top of the screen. Tap the notification and the page will open on your device's default browser. On Android phones, install or use your preferred QR code reader app.

spec´trum, n.

A broad range of related ideas or objects, the individual features of which tend to overlap so as to form a continuous series or sequence.

— *Random House Unabridged Dictionary*