KOVITZ INVESTMENT GROUP
Intrinsic Values®

Market Insights
Winter 2017

We are happy to report 2016 was an exceptional year, with Kovitz results exceeding expectations across each asset class. Furthermore, our financial planning efforts continued to help clients navigate towards their long-term goals as we look towards 2017 and beyond.

The Core Equity strategy[1] had a very strong year, posting a gain of nearly 20% (please see the strategy newsletter beginning on page 5 for greater detail). In Fixed Income, our decision to focus our purchases in bonds with short durations as a response to the ultra-low interest rate environment that prevailed for most of the year paid off as interest rates unexpectedly rose sharply in the fourth quarter. We are now deploying client capital at higher, more attractive interest rates. Finally, our various alternative investment strategies each turned in very strong results. This includes an opportunistic position in high yield closed-end funds which we initiated about a year ago for certain clients. This strategy was also additive to clients' annual risk adjusted results. Importantly, we continue to believe all of these strategies – taken together – continue to be helpful in helping our clients achieve their long-term goals.

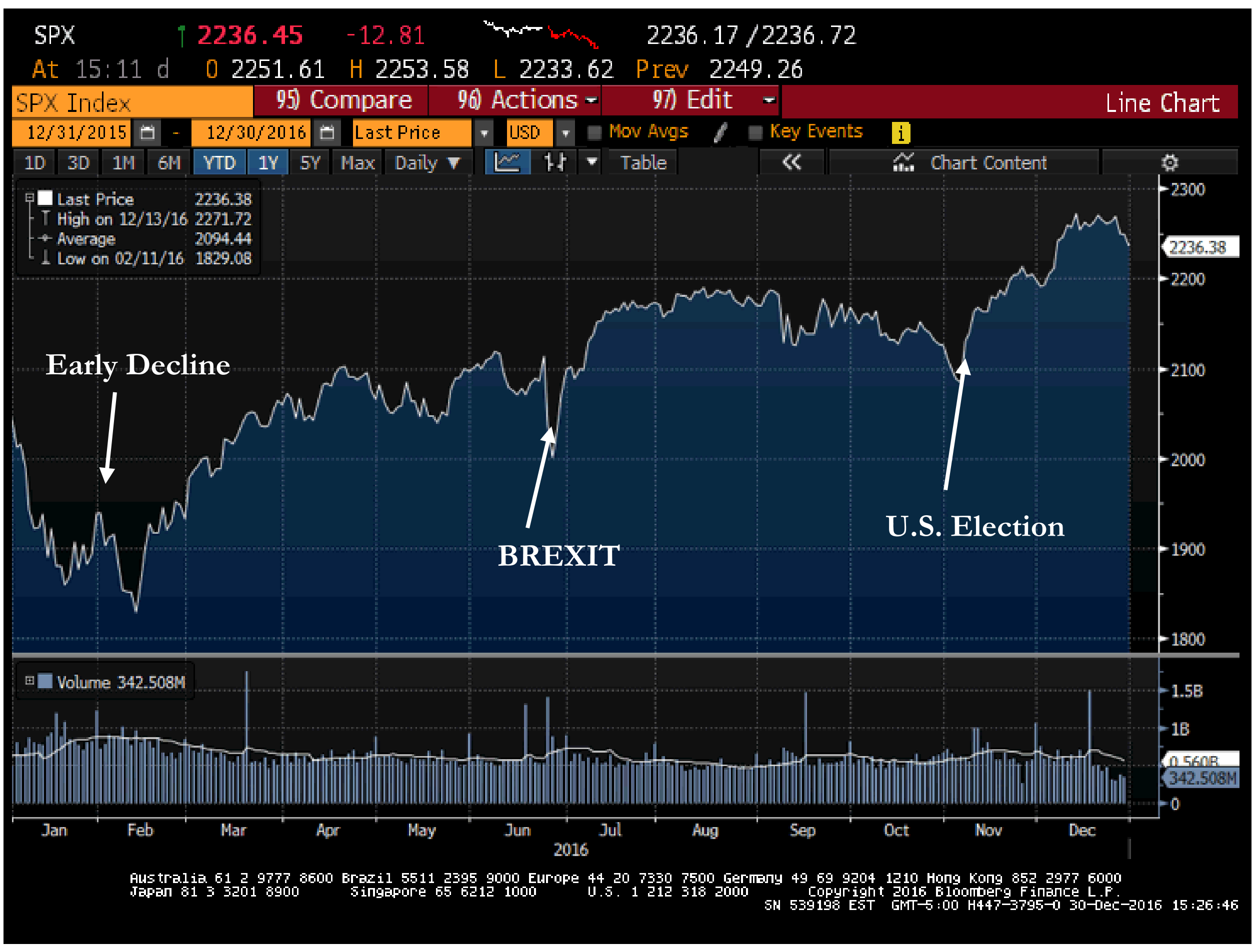
Interestingly, 2016 was fraught with opportunity to cause sizeable harm to your portfolio. The year began with a 10.3% decline in stocks[2] in just the first 6 weeks of the year. At the time, the prevalent market view was stocks would likely continue to decline. Of course, the opposite happened, and stocks surged 15% from the February low through June 22nd. It is for these reasons that we take a long-term view and don't try to predict or time the market.

June 22nd may sound like a randomly chosen date, but it is noteworthy because it was the day before the United Kingdom held a referendum vote on whether or not to leave the European Union. For months, polls predicted a "Stay" vote would prevail, and experts declared that a vote to "Leave," as unlikely as it seemed, would almost certainly spell doom for the UK's economy. Yet, on June 23rd, the UK voted to leave the European Union. Shortly thereafter, Google Analytics reported that searches for the phrase, "What happens if we leave the EU?" spiked in the UK on the day *after* the referendum. In a moment that helps prove the old saying, "the truth is stranger than fiction," who could have predicted that the same people who voted to leave would, after the fact, search the internet hoping to find out what it meant to do so? Much as in February, the widely accepted consensus view was that a "Leave" vote would be very bad for financial markets. As it turned out, equities fell only 5.3% in the two trading days following the vote, and the most surprising thing of all was when equities regained nearly all of their pre-Brexit value within another three days.

[1] Represented by the Kovitz Investment Group Equity Composite.
[2] Represented by the S&P 500.

Next the U.S. elections came into focus, where a chronology very similar to the Brexit vote unfolded. Both the expert political consensus and the implied market consensus was that Hillary Clinton would defeat Donald Trump by a large margin. Much like Brexit, it was believed that a surprise Trump victory would result in a significant market sell-off and extreme volatility. This prediction held through the exit polls. Again, in shocking fashion, the consensus prediction turned out to be wrong. Not only did the low probability candidate win the election, but stocks rose dramatically through year-end.

Perhaps even more importantly, the yield on the 10-year Treasury bond spiked from 1.88% to 2.45% by the end of the year. As has been discussed many times over the last 5 years, interest rates have been held stubbornly low, and the risk of deflation has been very real. There can be no greater surprise in 2016 than a victory by a candidate that was predicted to spell doom that has instead caused the stirring of Adam Smith's "animal spirits." The increase in appetite for risk taking behavior is thought to be the main reason interest rates have moved up, and, if it persists, this could be the beginning of interest rates normalizing. Hopefully, this uptick in anticipated growth and inflation will ultimately help greater levels of economic activity materialize.



As the above 2016 financial markets recap reveals, many market participants remain enamored with the idea of predicting the future and making investment decisions based on those predictions. If it were possible to do so with a likelihood of repeatable success, we would gladly employ this method.

However, a careful study of the greatest investors throughout history shows none of them have employed such a method. Unfortunately, the 24-hour news cycle promotes the business of making short-term predictions, while it decidedly ignores the ramifications of those predictions often straying far from reality. As 2016 so aptly illustrates, the only thing more unpredictable than the future is the short-term reaction of financial markets to future events.

In this year alone, investors following the consensus would have sold out of equities in January before stocks moved up substantially. Then they would have bought back in, only to sell on a surprise Brexit "Leave" vote, and then compounded the mistake yet again by selling on a Trump victory. Our effort to guard our clients against this behavior is our number one goal as your financial advisor. Each of these short-term, consensus-following decisions would have undoubtedly felt good at the time because there would have been plenty of testimonials out there saying it was the "smart" thing to do. However, in each case, significant damage would have been done to an investor's asset base, and by association, their ability to fund their long term goals.

While our ability to predict the future remains as elusive as everyone else's, in its place we continue to utilize what we have found to be a highly repeatable process grounded in maintaining our investment discipline. We value assets across all asset classes and only when the valuation becomes cheap enough do we accept the risk of owning those assets. Over time, this investment discipline skews the odds heavily in our favor. While we never know the timing of when returns will come, we believe that maintaining this long-term view is the best process to guard against permanently losing money while producing above-average returns over time.

Current Portfolio Positioning

As we discussed last quarter, we continue to view our primary job as maintaining a disciplined approach to managing our clients' portfolios where valuation is the bedrock of all investment decisions. The current environment remains highly unusual, where lower-than-average interest rates have caused higher-than-average equity valuations. Even more unusual, it is possible fiscal stimulus in the form of corporate tax cuts, personal tax cuts, repatriation of overseas cash, and infrastructure spending could ultimately justify the high starting point of valuations.

In such a paradoxical environment, we believe it is most important to guard against a permanent loss of capital while opportunistically focusing on high quality opportunities. We are invested side-by-side with our clients and we will continue to be more than happy to take a pass on investments with inferior return prospects and elevated odds of losing money. Across our strategies, we are positioned as follows:

1. In equities, we remain defensively positioned. Cash levels remain elevated as we have been trimming stocks that have reached our fair value estimates. We remain focused on a portfolio of competitively advantaged businesses trading at significantly lower valuations than the market as a whole. This is discussed in much greater detail in our accompanying Core Equity commentary.
2. In fixed income, we have begun to lengthen the duration of portfolios as interest rates have risen. As always, we are maintaining very high credit quality levels and do not believe in

reaching for yield at the expense of a possible impairment of principal. Please read more about this in our accompanying Fixed Income Commentary.

3. Where appropriate, we continue to recommend the inclusion of some alternatives (hedged equity, real estate, etc.), where a more suitable risk/reward profile might exist. An enhanced risk/reward profile often results as a tradeoff for assuming less liquidity than in the public markets.

As always, please discuss your particular situation with your KIG financial advisor.

Best Regards,

Kovitz Investment Group

Kovitz Investment Group

Core Equity Commentary

Winter 2017

Market and Performance Summary

For the fourth quarter of 2016, the Kovitz Investment Group (KIG) Equity Composite[1] (the "Composite") appreciated by 13.1% and finished the year with a gain of 19.5%. For purposes of comparison, the S&P 500 rose 3.8% during the quarter and ended 2016 with a gain of 12.0%.

We are pleased with these results and note that they were achieved while the Composite held a fairly large cash balance of approximately 8%, on average, during the year. The implication is that these returns were generated while employing less risk than the overall market (typically, to earn higher returns, investors need to take on even more risk). The build in cash is a direct result of our bottom-up investment style and in no way indicates any top down macro view or attempt to time the market. Rather, it's due solely to the fact that we have had more opportunities to sell current holdings at prices near intrinsic value than to buy new holdings at significant discounts to intrinsic value. We will be ready and eager to deploy cash as genuine opportunities present themselves.

If you recall, the year 2016 began with what had been termed the worst first six weeks in equity market history—the S&P 500 declined more than ten percent from its 2015 close through February 11. In June, the market went down over five percent in just a couple of trading days following the Brexit vote. Yet despite all that unnerving market volatility, the S&P 500 closed out the year near all-time highs. In a sense, the equity market of 2016 was a tutorial on the perils of attempting to time the market, and highlighted the wisdom of tuning out shocking current events and the attendant volatility. During such episodes, it's almost always better for your pocketbook to tune out the noise.

We did just that and many of our formerly untouchable stocks caught a bid beginning in the late summer, which resulted in our Composite outgaining the S&P 500 by nearly 12% over the second half of the year. We have consistently repeated that when you invest as we do by ignoring index weightings and avoiding what is currently popular, returns can and will be lumpy. We have also indicated that because we are agnostic on the timing of the returns, we are able to exploit one of the few edges left in the market. We call it "time arbitrage." Our definition of time arbitrage is being able to extend one's time horizon past that of the short-term mentality employed by most on Wall Street, and thereby exploit the benefits of moving against the herd. It's grounded simply in our willingness to view businesses through a different lens than the majority of investors, which enables us to buy companies with healthy long-term fundamentals at attractive prices because the stocks are temporarily out of favor due to short-term fears. We believe this arbitrage creates big opportunities for those with patience and discipline, and is a real and sustainable edge that is likely to endure as investment timeframes continue to get shorter and shorter.

Besides various market sectors just being overdue for a basic reversion to the mean as we have discussed in our previous commentaries, we believe a main driver of the "delayed gratification" in

[1] The returns for the equity portion of your individual account may differ somewhat from the Composite due to slight variations in account holdings, cash position, and other client-specific circumstances.

recent returns was due to the sharp move higher in interest rates that began over the summer and continued to gain steam post-election. The Federal Reserve raised the short-term interest rate target in response to generally positive economic data, but the move in longer-term interest rates was supercharged by the perception that the new administration will push for higher levels of fiscal stimulus in the form of lower corporate and personal income tax rates, increased infrastructure spending, the potential for repatriation of offshore cash at reduced tax rates, and a general reduction in the regulatory environment. Long-term interest rates are very sensitive to inflation expectations and the expected combination of a short-term boost to GDP and increased deficit spending has generated an immediate increase in the outlook for inflation.

In an economy that previously struggled under stubbornly low inflation and a stock market that seemed to imply that interest rates would never move above their current level, new expectations of higher interest rates provided an immediate boost to many of our portfolio holdings in the financial sector, which is our largest sector holding in our portfolios. Going forward, these companies will benefit particularly well if the yield curve continues to steepen (i.e. long term rates rise more than short term ones). Meanwhile, the purported infrastructure spending plans would likely be a boon to many of our other cyclically-related holdings, particularly those in the industrial sectors. We also hold many companies with considerable cash balances outside the U.S. who have heretofore been reluctant to bring it back to the U.S. and pay the full corporate tax rate of 35%. Regardless, we're most grateful that Mr. Market has begun to weigh our companies more appropriately.

The market is currently pricing in better economic results in the coming years than what has been experienced over the past several years. We don't know if the hype surrounding the new administration's agenda will lead to better economic growth or not, but we believe we are well positioned regardless. Ultimately, our Composite's outperformance relative to the market this year was not due to any superior ability we possess in forecasting the outcome of any single election or predicting the policies of a new administration. Our results were due to one of our core tenets of investing. We aim to buy companies at prices that provide meaningful upside if current market expectations come to fruition and that provide substantially more upside if reality differs from the expectation. Our Composite portfolio wasn't overweight Financials and Industrials because we had an opinion on the election. We were overweight those companies because they were priced as if their economic prospects would never improve. Any deviation from that expectation would provide outsized returns relative to a market valuing other companies, such as Consumer Staples and Utilities, as if their economic prospects were and would remain great forever. When expectations changed, the reaction was swift and we were well-positioned.

Even with this quarter's sound showing, there is still a significant valuation gap between our portfolio holdings, in aggregate, and sectors where we have little or no exposure. The wide valuation disparities that characterize the current market offer significant opportunities for active management; however, the net result of higher markets is that our opportunity set becomes more limited. Our backlog of analyzed (but still somewhat unattractively priced) securities continues to grow. This is akin to having acquired the seeds but waiting until the right season to plant them. In the meantime, we must remain objective and refrain from predicting what a government will or will not do and continue to be guided by company-specific valuation parameters. We relish the future as long-duration owners of high quality companies priced at meaningful discounts to the overall market.

While we never lost confidence that our holdings' growing intrinsic values would ultimately be recognized by the market, patiently waiting for this outcome can be painful in the short-run. In the long-run, we believe your patient capital, alongside of ours, will be amply rewarded for following our investment discipline instead of following the crowd. We would not be comfortable investing your money or our own in any other way.

In somewhat of a milestone, the end of this quarter marked the twentieth anniversary of our documented performance history. The chart below summarizes annualized performance over various standard time periods ending December 31, 2016 and cumulative performance results from January 1, 1997 through December 31, 2016 for the Composite.

KIG Composite[2]
Annualized and Cumulative Equity Performance (Net of Fees)

	Average Annual Total Returns						Cumulative
For Period Ending 12/31/16	**1 Year**	**3 Year**	**5 Year**	**10 Year**	**15 Year**	**Since Inception 1/1/97**	**Since Inception 1/1/97**
KIG Composite	19.5%	5.8%	13.4%	6.5%	7.2%	10.6%	647.7%

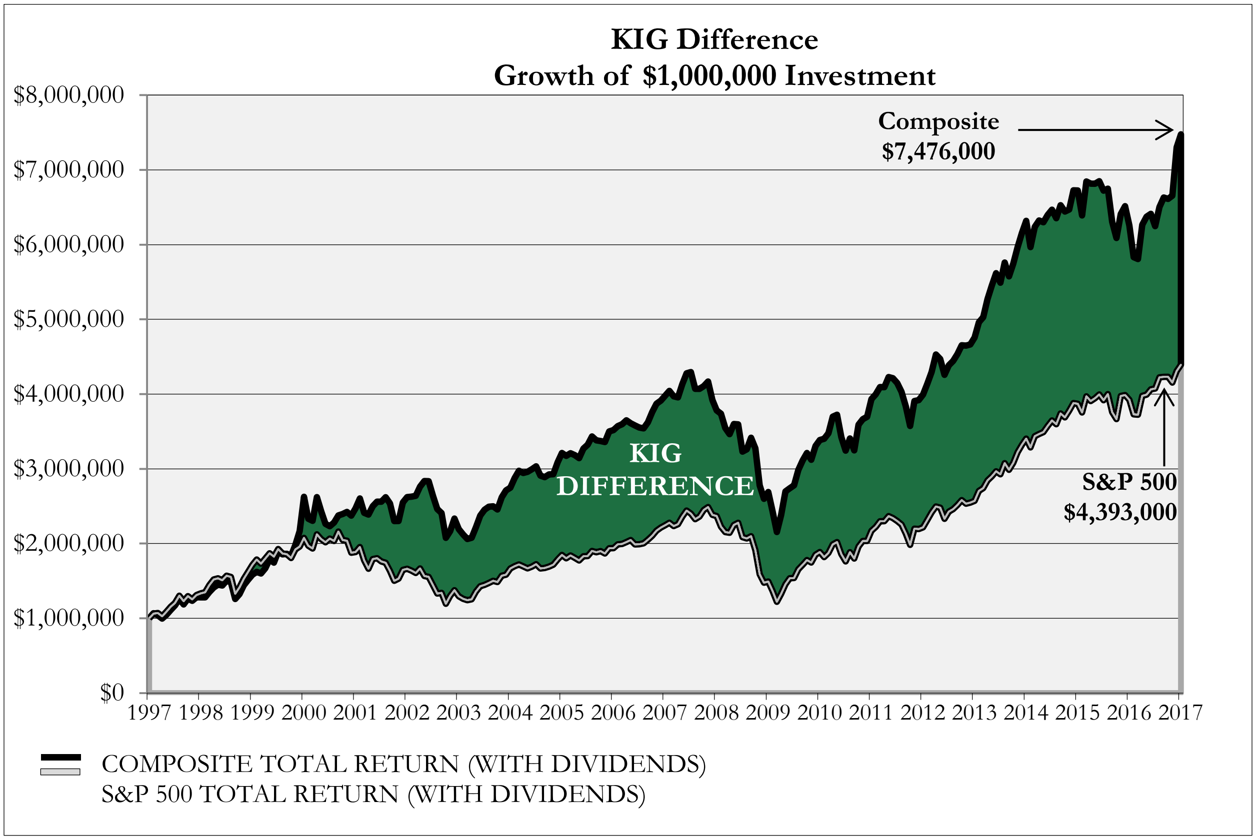
[2] The returns for the equity portion of your individual account may differ somewhat from the Composite due to slight variations in account holdings, cash position, and other client-specific circumstances.

The table below lists the results for the same time periods as above for the S&P 500 (the benchmark for the Composite), and many of the other benchmarks widely held as investments via a style-box approach.

Other Market Indices
Annualized and Cumulative Equity Performance

	Average Annual Total Returns						Cumulative
For Period Ending 12/31/16	**1 Year**	**3 Year**	**5 Year**	**10 Year**	**15 Year**	**Since Inception 1/1/97**	**Since Inception 1/1/97**
S&P 500	12.0%	8.9%	14.7%	6.9%	6.7%	7.7%	339.3%
Small Cap Equity (Russell 2000)	21.3%	6.7%	14.5%	7.1%	8.5%	8.2%	387.8%
International-Developed (MSCI-	1.0%	-1.6%	6.5%	0.7%	5.3%	4.2%	126.4%
International-Emerging (MSCI -	11.2%	-2.6%	1.3%	1.8%	9.5%	5.2%	174.6%
Gold	7.7%	-1.9%	-6.5%	5.3%	9.1%	5.5%	194.0%
Commodities (CRB)	9.3%	-11.8%	-8.8%	-5.4%	1.8%	-0.1%	-1.0%

Below is a graph of the Composite's cumulative return since inception relative to the cumulative return of the S&P 500 over the same time period. The shaded area represents the Composite's excess return over the benchmark.



Portfolio Activity

Despite our research team's best efforts, we did not initiate any new positions during the quarter. We continue to look for companies that have strong balance sheets, generate significant free cash flow, have management teams that allocate capital to maximize per-share value, and that sell at a discount to our estimate of fair value. Finding candidates that meet the first three criteria has always been somewhat difficult, but it is the fourth criteria – price – that has been the major impediment. As we have lamented on more than one occasion recently, bargain priced stocks are tough to come by these days. We continue to delve into the sectors where we have less representation, but have had limited success finding candidates that offer the combination of business quality and price we require. As mentioned above, we continue to like what we currently own from a quality and price standpoint and trust we will get opportunities to deploy our excess cash in due time.

We didn't stand completely still during the quarter as we increased our position sizes in **CVS Health (CVS)** and **McKesson (MCK)** who both act as important mechanisms in the pharmacy sector (CVS in retail pharmacy and pharmacy benefit management and McKesson in drug distribution). Health care and companies related to the pharmaceutical industry, in particular, have woefully underperformed the market this year. While we are currently unenthusiastic about the prospects for drug manufacturers (even though there may come a point where valuations start to look attractive despite business challenges), current valuations of these two companies have gotten way too cheap, in our opinion, for the quality, scale, and unique suite of assets each of these businesses possess. Earnings growth has slowed for each, but we believe the factors causing this, such as low levels of drug inflation and certain competitive pressures, are transitory and earnings power is likely higher than what is being booked currently. We can never predict the timing of when prices will rise or fall, but we can take advantage of price volatility when we own companies with stable values, such as these two.

We exited our position in **American International Group (AIG)**. . We held it in the Composite for approximately four years and its price compounded at a rate in the mid-teens over that time period (dividends added roughly another 1% per year). As price and value converged, our margin of safety narrowed, and we sold AIG with the expectation that we will reallocate the proceeds into more discounted names.

We also sold out of our position in **Kohl's (KSS)**. We would not classify it as a good investment because the annualized return over the entire period in which we owned it, although positive, was less than that of the overall market during the same period. In our opinion, Kohl's management has done an admirable job in keeping Kohl's stores relevant in an increasingly difficult environment for brick-and-mortar retailers. The convenience of online shopping has drastically changed shopping habits and it is increasingly difficult to drive physical traffic to your store base even though Kohl's has actually excelled in adapting to this changed world. The problem, which may seem counter-intuitive, is that online sales at a company with a large physical presence, unless the online sales are purely incremental to previously store-based sales, reduce the company's overall margins as shipping costs and increased technology costs add to the expense base. While Kohl's continues to produce a significant level of free cash flow, online competition continues to increase as a percentage of overall sales and to believe fair value is meaningfully above the level at which we sold requires us to believe margins are likely to hold steady or even increase from here. This is an outcome we deem to be less likely now than we did even 3 months ago. As investors, it is remarkable (and a bit frightening) to us that retail, once an area where we typically found great value, has become practically uninvestable. To be clear, most of the major, publically traded retailers are not going away, but the major challenges of decreasing customer traffic, margin degradation, and changing consumer preferences from material goods to experiential products make us wary of the sector.

Finally, we used post-election strength to pare back our exposure to a handful of names, including **Bank of America (BAC)**, **Jacobs Engineering (JEC)** and **Quanta Services (PWR)**. As equity managers focused on price and value, we seek to increase the size of our positions when the market disagrees with our long-term view, and do the opposite when the market ceases to provide us with as large of a margin of safety. These three stocks epitomize such behavior. As the market failed to recognize each company's normalized earnings power, we reviewed our thesis, worked through our upside/downside scenarios, and then took action by substantially increasing our position. Performance gains tend to experience a fair degree of lumpiness. This year (and primarily in the fourth quarter), the market's view caught up to our own and we were able to substantially reduce our position sizes in each.

Key Contributors/Detractors to Results

For calendar year 2016, the individual positions that impacted Composite performance the most during the year were:

Top 5 Contributors		Top 5 Detractors	
Company	Percentage Return*	Company	Percentage Return*
Quanta Services	72.1%	**CVS Health**	-17.8%
Halliburton	61.7%	**McKesson ****	-15.7%
CBS Corp	36.6%	**Walgreen Boots Alliance**	-1.0%
Jacobs Engineering	35.9%	**Coca Cola**	-0.3%
Valmont Industries	34.4%	**Walt Disney**	0.7%

* Including impact of dividends

** Measured from initial purchase in April, 2016

Largest Current Positions

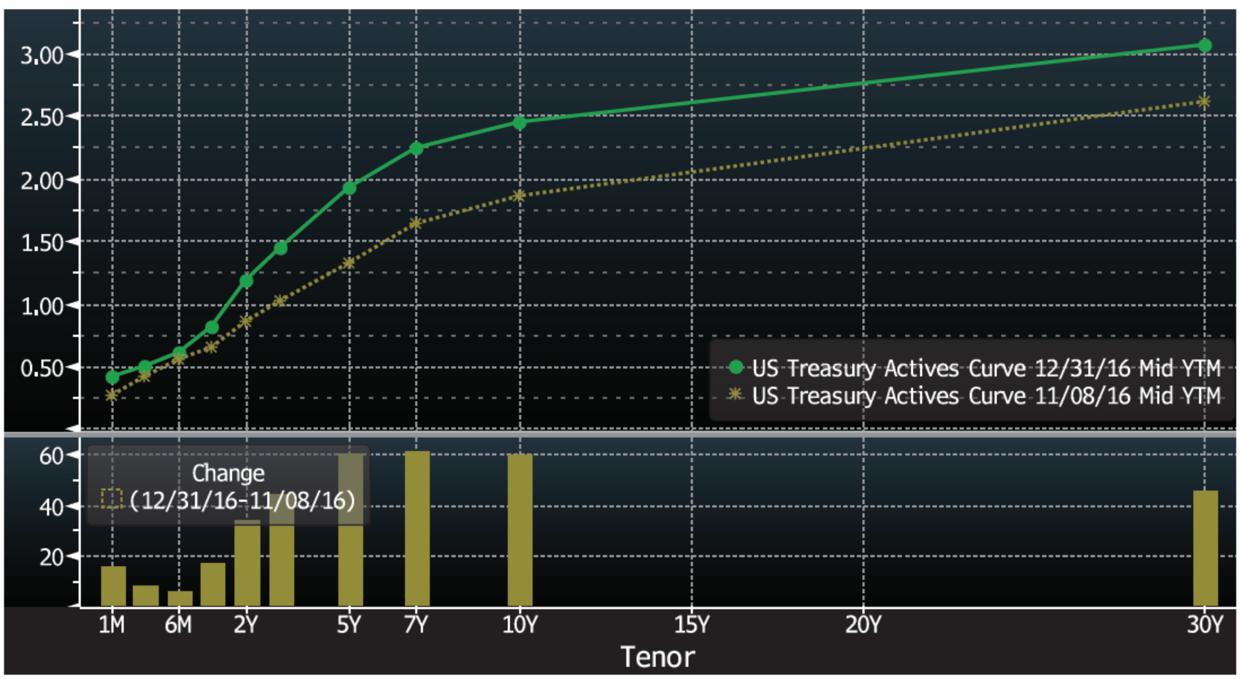
As of December 31, 2016, the Composite's ten largest positions were:

Company	Ticker
Berkshire Hathaway	**BRK.B**
Quanta Services	**PWR**
Apple	**AAPL**
JP Morgan	**JPM**
Bank of America	**BAC**
CBS Corp	**CBS**
Boeing	**BA**
General Motors	**GM**
Halliburton	**HAL**
CVS Health	**CVS**

We appreciate the faith that you, our partners, have placed in us to manage your capital on a long-term basis. Your patient capital and shared long-term time horizon provides a tremendous advantage as we go about our investment decision making process. Managing other people's money is an enormous responsibility and we hope you take comfort in the fact that we are doing the exact same thing with our own money as we do with yours.

Financial news outlets focused on rallying stocks after Election Day, but arguably the largest changes in the investment landscape were actually seen in the bond market. As discussed earlier in the newsletter, interest rates around the world pushed higher post-election due to perceptions that the new administration will produce faster economic growth, higher inflation and steeper short-term interest rate increases. All of these factors have historically led to increasing bond yields.

Exhibit 1 shows the US Treasury yield curve (the yields of US Treasury securities across varying key maturities) on the day before the election and at year-end. The yield on Treasuries with ten years until maturity increased from 1.86% on November 8th to 2.45% by the end of the year. While an increase of this magnitude in absolute terms is not unprecedented, it still represents a 32% increase in less than two months and the highest yield on the ten-year Treasury in over two years. The Treasury yield curve also steepened, erasing a period of historically flat curves – meaning the yield on longer dated maturities increased more than shorter maturities. For example, the yield on a one-year Treasury only increased 0.2% versus 0.6% for ten-year maturities.



In the market for municipal bonds, the change in interest rates was notable for another reason. In addition to the factors influencing Treasuries, the increased probability that personal income tax rates will decline under the next administration put downward pressure on the prices of municipal bonds versus taxable bonds of similar credit quality because lower tax rates reduce the value of the tax-exempt status of these bonds. Between the election and year-end, the yield on ten-year AA-rated general obligation bonds (a typical benchmark in the municipal bond market) increased 29% from 2.04% to 2.64% while the yield on ten-year AA-rated corporate bonds only increased 19% from 2.76% to 3.28%.

What does this mean for Kovitz bond portfolios? After a period of overweighting our bond ladders with shorter maturities in response to the relatively meager incremental yield offered by the market on intermediate-term maturities, we believe the higher and steeper yield curve now available compensates us more fairly for investing in longer-dated maturities. As a result, clients may begin to notice an increase in the concentration of bond purchases maturing in 2023 through 2025 in the new year as we attempt to take advantage of the new interest rate environment and normalize our bond ladder maturity years. Our focus in shorter maturities allowed us to weather the uptick in rates better than we otherwise would have (shorter bonds decrease in price less than longer bonds when rates rise, all else equal) and it now provides plenty of bonds coming due in the next year or two that will be reinvested at higher yields. This of course assumes that interest rates do not return to their pre-November 8th levels anytime soon, which is something we have no way of knowing.

Closed-End Fund Commentary

We first started buying closed-end funds in December 2015, and the strategy has outperformed our expectations over the last year. Even though we avoided, and even discouraged, closed-end funds in the past, we thought the market for closed-end funds that invest in high-yield corporate debt presented a unique opportunity at the time.

For background, closed-end funds have a fixed amount of capital and a fixed number of shares that trade on an exchange in the same fashion as common stocks. Unlike typical open-end mutual funds and ETFs, their market prices can vary – sometimes significantly so – from their net asset value. Because of their fixed capital base, these funds also typically employ leverage, although the amount of leverage varies among individual funds depending on the underlying assets owned by the fund and the discretion of the manager.

While many closed-end funds regularly trade at some discount to their net asset value, we observed unusually large discounts for closed-end funds that invest in high-yield debt. The dislocation seemed to stem from a combination of two factors: 1) the perception that rising short-term interest rates would increase borrowing costs for leveraged funds, and 2) expanding credit spreads[1] for fixed income instruments caused a decline in the net asset value of many funds. Because of these factors, investors in closed-end funds, who were traditionally individuals attracted solely by the leverage-enhanced distribution rates offered by these funds, began abandoning the space. This sustained selling pressure expanded the difference between market price and net asset value to levels not seen since shortly after the financial crisis of 2008.

Similar to most of our successful investments, our decision to buy was made when everyone else seemed to be selling. Despite our prior aversion to the asset class, we ultimately determined that the combination of closed-end funds trading at discounts to NAV approaching 15% in many cases, and high yield bonds trading on the cheap end of historical norms, had stacked the odds in our favor.

[1] Credit spreads are the difference in yield between bonds of differing credit quality. As credit spreads expand, bond yields increase and high yield bond prices decrease.

We selected funds that were invested in high yield corporate bonds, bank loans[2], and asset-backed securities that we felt offered the best risk-return profile. We also used a diversified portfolio approach to minimize the risk to the portfolio of any single fund performing substantially worse than the asset class as a whole.

Flash-forward to today and our thesis has proved correct thus far. High yield bond prices have rallied throughout most of 2016 as investors have become less concerned about credit risk. This has increased the net asset values of most of our funds markedly. The market price discount of our closed-end funds also narrowed. Some sectors of the closed-end fund market are more in vogue than others, such as floating-rate bank loan funds, which has afforded us the ability to exit a few funds at narrow discounts, while the rest of our portfolio has remained relatively cheap to net asset values.

We've continued to search for opportunities to add to our portfolio, but the narrowed discounts and pricier valuations of the underlying assets that drove the performance of this strategy throughout the year has also limited our ability to deploy new capital. It would likely take another significant expansion of credit spreads or fund discounts for us to see a sufficient margin of safety to commit new capital. In the meantime, we are content wait until the right risk/return profile presents itself – whether that is in the closed-end fund market or an alternative.

[2] Bank loans, sometimes referred to as leveraged loans, are typically made to businesses that are too small to attract enough demand to float a typical bond issue. In terms of risk, these securities are similar to high yield bonds and they typically have floating-rate coupons.

Financial Planning Corner
Winter 2017

From time to time, we will add this section to our newsletter. In it, we will discuss a wide variety of financial planning and wealth management topics, including estate planning and wealth transfer strategies, income-tax-saving strategies, social security and retirement planning ideas, charitable giving, insurance planning and beyond. Our hope for these pages is that you will periodically find something interesting (and profitable) that touches a current or future need of yours which causes you to pick up the phone and call your Kovitz Advisor to start a conversation.

Charitable Giving and Donor-Advised Funds

Each December, consumers of financial media are bombarded with articles singing the praises of year-end tax strategies with the most common format being of the "Top 12 Year-End Tax Tips" variety. Much of the information contained therein is sound advice, but the trouble is that many of these tactics become dramatically less useful when the clock strikes midnight on New Year's. So instead of focusing on the Ghosts of Tax Strategies Past, we believe it is more beneficial to channel our energies into potential tax-saving strategies we can use now that 2017 is upon us. One such strategy is planning charitable giving that capitalizes on the benefit of donating shares of stock as opposed to the typical cash donation.

In lieu of cash donations, many charitable organizations have the ability to take receipt of securities (stocks, bonds, etc.). If an organization can facilitate this, an individual may be able to donate highly appreciated securities from a taxable account, thus entitling the owner to a tax deduction in a similar manner to making a cash contribution. The main advantage of this form of donation is that the donor forever avoids paying tax on the future capital gains embedded in those appreciated securities.

For example[1], if an individual in the 39.6% federal tax bracket makes a $50,000 cash donation to a tax-exempt charitable organization, this results in federal income tax savings of $19,800 ($50,000 x 39.6%). However, if this same individual donates the same $50,000 in the form of appreciated securities that were purchased many years ago for, say, $10,000, the tax savings rise to $29,320. The additional $9,520 in tax savings in this example arises from the avoidance of paying capital gains taxes (at a 23.8% rate) on the $40,000 capital gain embedded in the donated shares.

For those organizations that can't take possession of securities or for smaller contributions where a stock transfer is overly complicated, there is a better solution. Over the last 20+ years, the use of donor-advised funds (or "DAFs") has been steadily rising. A DAF is an account opened through a DAF provider (such as Fidelity, Charles Schwab, Vanguard, AEF, etc.) for the purpose of making distributions to charitable organizations. Similar to making a contribution of appreciated stock directly to charity, an individual would instead make an irrevocable transfer of securities to the DAF, which qualifies for the same charitable tax deduction as a direct donation to charity.

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[1] State income taxes are ignored in this example for the sake of simplicity, but there would be additional tax savings generated at the state level using the same strategy.

A main contributor to the growing popularity of DAFs is the flexibility they provide after the contribution has been made. Depending on the desires of the account owner, the fund can immediately forward all proceeds to a 501(c)(3) charity of the owner's choice or the proceeds of the donation can be invested in one of the DAF's investment options until a later date. The latter option provides the potential to grow the account's balance on a tax-free basis to facilitate even greater charitable giving down the road. Many donors hold a significant balance in their DAF and gradually peel off donations over many years. This "slow-burn" feature allows donors to front-load their contributions to a DAF in years with especially high taxable income, maximizing the tax benefit received in the year of the contribution.

As always, there are numerous caveats and limitations that may inhibit any particular individual's ability to take full advantage of the tax benefits described here, not to mention the potential changes to the tax code that may encourage/discourage taking action this year. Regardless, our team of financial advisors at Kovitz is committed to staying abreast of any new developments on this topic and many others. As always, please feel free to reach out to your Kovitz advisor to discuss the extent to which this or any other financial planning strategy could take a bite out of next year's tax bill.

Kovitz Investment Group

Intrinsic Values®

Mary Anderson, MBA
312.334.7355
manderson@kovitz.com

Jenny Boyke, MAS, CPA, CFP®
312.334.7316
jboyke@kovitz.com

Marc Brenner, JD, CPA
312.334.7302
mbrenner@kovitz.com

David Castro, CFP®
312.334.7361
dcastro@kovitz.com

Andrea Cohen, CFP®
312.334.7312
acohen@kovitz.com

John Conway, CRPC®
312.334.7343
jconway@kovitz.com

Ed Edens, MBA, CFP®
312.334.7333
eedens@kovitz.com

Amanda Falkum, CFP®
312.334.7351
afalkum@kovitz.com

Skip Gianopulos, JD, LLM, CFP®
312.334.7303
sgianopulos@kovitz.com

Leonard Gryn, CPA
312.334.7360
lgryn@kovitz.com

Joel Hirsh, CFA
312.334.7307
jhirsh@kovitz.com

Debbie Hopkins, MBA, CFP®
312.334.7325
dhopkins@kovitz.com

Kate Jonynas, CFP®
312.334.7309
kjonynas@kovitz.com

Mitchell Kovitz, CFA, CPA
312.334.7301
mkovitz@kovitz.com

Sanford Kovitz, JD, MBA
312.334.7352
skovitz@kovitz.com

William Lee
312.334.7335
wlee@kovitz.com

Melissa Mabley Martin, CFP®
312.334.7328
mmabley@kovitz.com

Bradford Madison, CTFA
312.334.7347
bmadison@kovitz.com

Christopher Nicholson, CFP®
312.334.7319
cnicholson@kovitz.com

Jack Nicholson, MBA, CFP®
312.334.7323
jnicholson@kovitz.com

Michael O'Hara
312.334.7331
mohara@kovitz.com

Jason Petitte, CFA
312.334.7311
jpetitte@kovitz.com

Mark Rosland
312.334.7322
mrosland@kovitz.com

Peter Rudman
312.334.7327
prudman@kovitz.com

Ted Rupp, MBA
312.334.7317
trupp@kovitz.com

Rich Salerno
312.334.7304
rsalerno@kovitz.com

Jonathan Shapiro, CFA, MBA
312.334.7324
jshapiro@kovitz.com

Jesse Stumpf, CFA
312.334.7320
jstumpf@kovitz.com

Bruce Weininger, CPA, CFP®
312.334.7334
bweininger@kovitz.com

Patrick Wiese
312.334.7305
pwiese@kovitz.com