Preserving Confidentiality and Protecting Wealth for the High-Profile Sports and Entertainment Client

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Anyone who follows sports has read the stories of the high draft choice who spends his bonus money on his mother’s new residence, the fancy condo in the city that drafted him, his fleet of “rides” and his identity “bling,” and then blows out his knee. Or the superstar who takes cash at the card shows where he appears and then is unable to pay his income tax bill when it becomes due on the 15th day of the fourth month of the following year. And of course we have heard stories of the retired athlete who no longer has sufficient income to maintain the child support obligations that were fixed when he was a Pro Bowl linebacker.

In its March 23, 2009 issue, SPORTS ILLUSTRATED reported that 78% of NFL players were either bankrupt or under severe financial stress because of joblessness or divorce within 2 years of the end of their careers. And within 5 years of retirement, an estimated 60% of former NBA players are broke.

IT DOESN’T HAVE TO BE THAT WAY; AND, MORE IMPORTANTLY, IT SHOULDN’T BE THAT WAY!

The high net worth families of entrepreneurs, business executives and even “trust fund babies” have sought proper advice and counsel from legal, accounting and financial professionals for tax planning, estate planning, and, more recently, asset protection planning. Today’s professional athlete is similarly considered a “high net worth family” – maybe a bit younger, and with less
experience in the business world – but with similar need for competent professional advice and guidance just the same.

 Accordingly, an integral part of any professional athlete’s “financial planning” (which traditionally focused primarily on (1) “hot” investments and (2) avoiding one creditor exclusively, the Internal Revenue Service) should incorporate the asset protection and exempt property statutes available under the laws of the jurisdiction where that athlete resides.

 We have found that a large percentage of current and former NFL players are tax residents of Florida. Aside from the glorious weather, Florida has no individual income or estate tax. Furthermore, Florida law provides under both its Constitution, as well as its legislative code, exemptions for certain types of property and property ownership from the claims of creditors of the property owner. Ostensibly, the purpose underlying such statutory exemptions is to allow citizens to retain some assets after financial hardship to avoid becoming wards of the state and the financial responsibility of its taxpayers.

 Consequently, the laws of each state may exempt any or all of the following property or interests in property from claims of creditors. With proper planning and trusted advisors, a professional athlete can and should structure his affairs to preserve and protect his assets, and maintain his financial security long after he “hangs it up.”

I. **HOMESTEAD**

 Under Art. X, Sec. 4 of the Constitution of the State of Florida, a Florida resident’s homestead is protected from any forced sale and liens resulting from judgments, decrees or executions if the homestead is the permanent residence of the owner or a legal or natural dependent of the owner; if the homestead is located within a municipality, the homestead is limited to one-half acre of contiguous land; and if the homestead is located outside of a municipality, the homestead is up to one hundred sixty acres of contiguous land.

II. **LIFE INSURANCE**

 Life insurance proceeds payable upon the death of a resident may be exempt from the claims of creditors of the insured and will inure for the exclusive benefit of the beneficiary of the policy unless the insurance policy provides otherwise, or unless it is payable to the insured’s estate. Some states limit the amount of death benefit which is so exempt; other states limit the types of policies so exempt, such as group life policies; and some states exempt policy proceeds depending upon the relationship of the designated beneficiary to the insured.

III. **CASH SURRENDER VALUES AND ANNUITIES**

 The cash surrender value of a life insurance policy and the proceeds of an annuity issued to a resident may not be subject to attachment, garnishment or legal process in favor of any creditor of the person whose life was insured or who was the beneficiary of the annuity unless the life insurance policy or annuity was purchased for the benefit of the creditor.
IV. QUALIFIED PLANS

Money or assets payable to a participant or beneficiary from or in a retirement or profit-sharing plan that is qualified for tax purposes under the Internal Revenue Code, including IRA’s and college savings plans under Section 529 of the Internal Revenue Code, may be exempt from claims of the participant’s creditors.

V. TENANCY BY THE ENTIRETY

In jurisdictions where available, many athletes rely on ownership of property as tenants by the entirety with a spouse because a creditor of only one individual spouse cannot reach such property to satisfy its claim without the consent of the other spouse. Tenancy by the Entireties is a form of ownership available exclusively to spouses; and must be distinguished from “joint ownership with right of survivorship” or “JTWROS”. However, this form of joint ownership is an ill-advised asset protection planning strategy in the event of a divorce, or the non-obligor spouse dies first. In that case, all of the assets will become owned exclusively by the surviving obligor spouse.

VI. ENTITY PROTECTION

1. LLC’s: An LLC, or “Limited Liability Company,” is a “hybrid” entity which combines the limited liability of a corporation and the flow-through taxation of a partnership. Based upon recent decisions arising out of the federal bankruptcy courts and certain state courts, other than with respect to a single member LLC, a court may “charge” a member’s interest in an LLC with payment of the unsatisfied amount of the judgment with interest. In other words, the creditor has a lien on any distribution to the member. In many states, the limitation of a judgment creditor’s remedy against an interest of a member in an LLC to a “charging order” against the debtor-member’s membership interest is the exclusive remedy which a creditor may use to satisfy a judgment, and other remedies, such as attachment or foreclosure, of that interest, are not available to a creditor attempting to satisfy a claim. Therefore, from an asset protection perspective, the charging order protection is an important and valuable benefit to the limited liability company form of business entity, as compared to a corporation that elects to be taxed under Subchapter S of the Internal Revenue Code. The shares of stock representing an ownership interest in an S corporation can be attached in satisfaction of a judgment against the shareholder; or perhaps may trigger a buy-out of the shares upon an involuntary transfer in accordance with the terms of a shareholders’ agreement, which exposes the cash down payment and promissory note to attachment in place of the shares.

2. LLP’s: An LLP, or “Limited Liability Partnership,” is a general partnership that has registered as a limited liability partnership and has the same qualities as a general partnership except that the liability of its general partners may be limited in certain circumstances. The charging order protection applicable to the members of LLC’s is similarly available to partners of LLP’s.
3. LLLP’s: An LLLP is a limited partnership that has registered as a “Limited Liability Limited Partnership,” and has the same qualities as a limited partnership except that the liability of its general partners (and its limited partners who may be deemed to be liable as general partners) may be limited in certain circumstances. Since, in the context of a family LLLP, the general partner is typically responsible for determining the amount and timing of partnership distributions, the right to receive distributions may be of little value to the creditor. Worse yet, the charging order may subject the judgment creditor to income tax as though the creditor were the owner of the partnership interest. The flow-through tax treatment applicable to partnerships provides that the creditor may have to pay tax on a share of partnership income whether or not any distributions of income have actually been made by the partnership to the partner.

VII. SPENDTHRIFT TRUSTS

If, the creator of a trust (commonly referred to as the “settlor” or “grantor”) wants to make sure the beneficiary’s interest will be preserved and protected from the beneficiary’s debts and obligations, can the settlor impose restrictions on the interest to preclude voluntary assignment of the trust assets. If so, will those restrictions prevent the beneficiary’s creditors from reaching the trust’s property?

Obviously, once a beneficiary receives a distribution from the trustee, the beneficiary is free to use the distribution as he wishes, and it becomes an asset, subject to the claims of his creditors indistinguishable from his other assets.

The foundation for acceptance of “spendthrift” trusts is found in the common law concept that maximum effort should be given to the objectives and intentions of the settlor. Historically, the general rule has been that the interest of a trust beneficiary, including the right to income from trust corpus, is alienable by the beneficiary. Additionally, the interest of a beneficiary is liable to be taken in satisfaction of his debts and obligations.

However, under most state laws trust assets may be protected against dissipation by a beneficiary or levy by creditors through creation of a “spendthrift” or similar protective trust. Provisions vesting discretion in the trustee to determine the time, amount, or manner of payments to the beneficiary likewise are recognized as valid. Historically, however, a spendthrift trust has been created to provide a fund for the maintenance of another while securing the fund against the beneficiary’s own improvidence or incapacity.

VIII. DOMESTIC ASSET PROTECTION TRUSTS (“DAPT”)

The general rule in the United States provides for non-recognition of self-settled spendthrift trusts (i.e., trusts in which the settlor retains a beneficial interest, and the trust instrument states that his interest cannot be alienated, either voluntarily or involuntarily). However, several states have now enacted legislation allowing self-settled asset protection trusts. Missouri was the first state to adopt asset protection trust legislation in 1989. There are now
fourteen states that permit a settlor to transfer assets to an irrevocable trust containing “spendthrift” provisions with respect to a settlor’s creditors under certain conditions.

IX. FOREIGN ASSET PROTECTION TRUSTS ("FAPT")

In contrast to a DAPT, a Foreign, or Offshore, Asset Protection Trust is an irrevocable trust established in a jurisdiction outside the United States for the primary purpose of protecting assets of the individual creating the trust. The trust isn’t intended to shelter all of the individual’s assets, but only provide a level of financial security, or a “nest egg”, in the event of a catastrophic financial crisis.

If structured properly, this is not a fraudulent scheme or a strategy to avoid creditors or evade taxes. In fact, a FAPT is not appropriate for an individual already engaged in litigation or actively trying to avoid payment of an enforceable obligation.

FAPT’s are usually established with banks or trust companies which are chartered in foreign jurisdictions where local laws provide very favorable conditions. For example, the local laws of many of these jurisdictions make it more difficult for a creditor to challenge the validity of property transfers into the trust.

From an income tax perspective, the arrangement is deemed a “grantor trust”, which means that all of the income must be reported by the creator of the trust. It must be clearly understood that there is no income tax benefit, shield or protection to be accomplished by establishing a nest egg trust.

The primary advantage of a FAPT over a DAPT is that a court in the United States does not have jurisdiction over the offshore trust, the assets of the trust or the Trustees of the trust. In contrast, it may be possible for a court in one state to enforce a judgment against a settlor who creates a DAPT in another state.
CASH MANAGEMENT MODEL

1. Budgeting
2. Debt management
3. Asset management
4. Payment of living expenses
5. Emergency reserves
6. Career transition reserves
7. Investment pool
8. Risk management
9. Disability planning
10. Death benefit planning
Preserving Confidentiality and Protecting Wealth for the High-Profile Sports and Entertainment Client
Stephen Erwin, J.D. is a private wealth manager and general counsel of Aveo Capital Partners, and its affiliate asset management firm Blue Sky Asset Management. His wealth management practice focuses on assisting families, business owners, attorneys, law firms, as well as entertainment and sports industry executives and talent to accomplish their life and wealth goals with an strong belief in putting the client’s interest above all else. Stephen manages the Sports and Entertainment Wealth Management division of the firm. His wealth management philosophy is to provide clients strong unbiased wealth and financial planning.

To accomplish clients’ investment planning goals, he works with clients to build core low-cost, global macro dynamically adaptive portfolios, using quantitative and technical, rules-based trading strategies. Our strategies focus on low drawdown risk, liquidity, transparency and consistent attractive annualize returns. He then helps clients to blend in satellite specialty, private and alternative investments to balance their portfolio objectives.

Stephen has spent the past twenty-five years working in the entertainment industry, beginning as a sound reinforcement engineer, recording engineer, artist manager, and music industry attorney before transitioning into the wealth management industry a decade ago. His clients have included professional athletes, recording artists & actors, songwriters, music producers, entertainment and other prominent attorneys, television and film producers, and Broadway theatrical producers.

For more information you can contact Stephen at se@aveocapital.com or 720-255-4354. www.aveocapital.com
Overview

This presentation is designed to provide an overview of the significant challenges facing investors, particularly those in the entertainment and sports industries. Our world is replete with stories of immensely successful entertainers and athletes who have faced hardship and even bankruptcy during their careers, or shortly after retiring. Below are only a few snippets taken from articles published in the past decade that tell a bleak story of greed, incompetence, fraud, ignorance and failed personal and business management.

“By the time they have been retired for two years, 78% of former NFL players have gone bankrupt or are under financial stress…” si.com, 2009.

“Ms. Warwick had a business manager who mismanaged her affairs...Before she know it, she owed a gazillion dollars in taxes.” Rolling Stone, 2013 (quoting Warwick’s attorney).

“In 2007 alone, [Nicholas] Cage’s shopping spree entailed the purchase of three additional residences at a cost of more than $33mm, the purchase of 22 automobiles (including 9 Rolls Royces); 12 purchases of expensive jewelry; and 47 purchases of artwork and exotic items.” Cnn.com, 2009 (quoting Cage’s former manager in a countersuit against Cage).

“Over the course of 17 years, I invested in a series of opportunities presented by [my financial adviser]. On his assurance that we were working together for my family’s long-term financial security ... [he] exploited my good intentions and our relationship for his own personal gain and my substantial loss.” Tim Duncan, Investment News, 2015.
Case Study 1

Tariq Morris is an All-Pro running back for the newly relocated Los Angeles Rams. Although he is not married, he has a live-in significant other with whom he has two children. In addition, Tariq has three children with three other women, two of whom are receiving court ordered child support, and one who has just filed suit.

Also living in Tariq’s recently purchased Belair mansion are various members of his entourage, for whom he provides food, financial support, use of automobiles titled in his name.

Tariq just signed a new contract for $50,000,000, of which $30,000,000 is guaranteed, and the remaining balance is paid over 5 years if he remains with the team at $2,000,000 for the first year, $3,000,000 for the second year, and $5,000,000 for each of the last 5 years.

In addition, Tariq has endorsement contracts with Under Armor, Gatorade, EA, and Godfather’s Pizza, that generates an additional $5,000,000 per year.
Case Study 2

Juston Deaf is an iconic rock star who has achieved “single name” recognition status (Cher, Elvis, Elton). His every move is covered by the paparazzi and his comings, goings and regular day to day activities are regularly published on social media.

Juston has hired new financial advisors who have designed a new financial plan for him in order that Juston no longer has to “hit the road” on a new concert tour whenever his spending exceeds his capital and income. However, the advisors are concerned that any investment strategy implemented, any investment partners or joint venture participants, or any financial institution relationships will soon be publicly disclosed.
The Importance of Planning

In order for any person to be successful in implementing their financial and retirement plan, proper planning is crucial and includes:

• Cash Flow Management and Budgeting
• Building the Financial Team and Conflicts Management
• Tax and Estate Planning and Structuring
• Investment Planning and Structuring
• Life Goals and Retirement Planning
• Private Investment Due Diligence
• Client Education and Expectations Management
• Unexpected Events and Exit Strategies
Top Reasons Entertainers and Athletes Lose Their Wealth

Entertainers and athletes face significant challenges to maintaining their financial security. Here are a few reasons they go broke:

• **Lack of Planning**—especially for the athlete with a 3-5 year career, or one-hit recording artists who fail to have a career plan B, and failing to save for retirement or long stretches with no income;

• **Poor Team Synergy**—building a competent team of professionals that work together in the clients’ best interest is important and often ignored. Team members can fail to understand they work for their client and attempt to hijack the client’s career for their own benefit through conflicts of interest. Independent team members who act as check and balance can mitigate this risk;

• **Unreasonable Lifestyle Expectations**—rookies trying to keep up with the Peyton Manning or young artists trying to spend like Jay-Z or Taylor Swift. Some clients just spend too much and won’t listen to reasonable advice. For some like Nick Cage, it appears to be a sickness;

• **Fraud**—these clients are targets for unscrupulous agents, managers, financial advisers, hedge fund managers and others who promise big returns only to siphon of the client’s wealth through a variety of nefarious schemes;

• **Lack of Knowledge**—both by the client and advisers who are too quick to engage in risky business ventures and investments without understanding the space or conducting proper due diligence;

• **Lack of Liquidity/Over-Leverage**—Talent and athletes tend to gravitate to “sexy” investments like private equity/venture capital, real estate, hedge funds and other alternative investments which have low liquidity, and may take out huge loans to finance their lifestyle. When income drops, this often leads to a liquidity crunch that causes client to file for bankruptcy.
Cash Flow Planning and Budgeting

• For athletes, particularly in the NFL, it’s important to know that players generally get on a game-by-game basis (with exceptions for small amounts for training camp, etc.) so salary payments substantially stop in the off season. Some players get caught off-guard and are forced to take out loans to cover expenses—there is an underground system in the NFL in which older players loan money at high interest rates to younger players.

• Realistic revenue projections are crucial for both current and rolling 3-5 year average gross and net income projections.

• Realistic lifestyle and expense projections are crucial for both current and rolling 3-5 year average expense projections.

• Analyze and plan for various income and expense scenarios—"If you buy this and don’t get that gig, or get hurt, or your portfolio declines, here is what can happen."

• Regular reporting of expense to income ratio—Clients need to know they are spending more than they are making or project to be making, even if they won’t listen.
Cash Flow Planning and Budgeting

- Credit, Leverage and Liquidity should be aggressively monitored.
  - Credit debt can mean more than mortgages and credit card debts
  - Leverage refers to investment leverage and margin
  - Liquidity refers to how quickly one can convert assets to cash in order to pay current debt obligations

- A Liquidity Crunch can devastate a client financially. Celebrities tend to gravitate to illiquid investments like real estate, private equity and hedge funds in order to chase high returns, only to find themselves unable to pay debt obligations and bills. This can lead to a forced fire-sale of assets and substantial losses, or bankruptcy if assets can’t be liquidated.

- For clients with less than $5mm of assets to invest, a rule of thumb is to recommend the client hold 25% or less in assets that can’t be readily liquidated. Clients should be able to generate their current income requirements from current income (which is expected to continue for at least one year) and liquid core investments. See slides below discussing liquid and illiquid investment strategies.

- “Rainy day liquidity fund” should be considered so clients can pay current obligations for one year if current income is lost. Disability insurance may also be a strong consideration.

- Tax planning and entity structuring can help increase current and retirement net income and protect assets from creditors.

- Set goals for family and entourage support and entertainment expenses.
Building the Financial Team and Conflicts Management

• Financial Team may include Personal Manager, Business Manager/CPA, Sports or Talent Agent, Financial Adviser, Lawyers, and Personal Assistant/Spouse.

• Each Team Member should acknowledge primary and secondary designated roles and responsibilities. “One-Stop-Shop” agents or advisers can be dangerous if unchecked. See e.g., Terrell Owens v. Drew Rosenhaus, et. al; Natural Wealth Rea Estate v. Leonard Cohen.

• Celebrities and athletes should have a “responsibility and conflict checklist” clearly identifying which service provider is obligated to perform which specific tasks, the fees associated with such services and the relationship amongst service providers, if any.

• The Sports Agent is primarily responsible for negotiation of the player contract and/or endorsement deals.

• Agents often advertise themselves or their firm as a one-stop-shop to provide agent services, legal and contract negotiation, marketing, financial services and concierge services, but likely will farm out accounting and financial adviser services to affiliated or unaffiliated providers for a referral fee.

• Agents often take on a “quarterback” role for clients and manage/screen additional service provider relationships. Great care should be taken to vet conflicts of interest and to ensure the team manager is acting in the best interest of the client.
Building the Financial Team and Conflicts Management

- **Personal Managers** for talent often take on a similar career manager/CEO role as a sports agent for an athlete and are active in contract negotiations, career development and take a percentage (15-20%) of all entertainment income.

- Personal Managers often have POA with their clients’ accounts authorizing them to execute agreements and access financial accounts, hire and manage other service providers and some strictly control client contact with such other providers (Leonard Cohen Case).

- **Business Managers** are the bookkeeper (account manager) and accountant (CPA) for the client who handle accounting for the clients’ business entities, state and federal tax filings and often handle personal financial management, family budgeting and bill-paying services. They either work for an hourly fee or percentage of income (typically 5%). Specialists may also conduct tour accounting.

- Business managers work closely with personal managers and financial advisers to manage the overall financial lives of clients, and sometimes take on a management role with the financial management team and may refer or vet the financial adviser. Regardless, all financial management team members must work in concert and communicate with one another to avoid costly errors, mistakes and fraud. Team members should be sufficiently independent to act as a respectful check on other team members.
Building the Financial Team and Conflicts Management

- Conflicts of Interest should be fully disclosed to clients including: referral fee arrangements; related-party transactions and business dealings, and relationship control are common issues.
- Referral relationship and related party transactions are the most common conflicts, but can be mitigated and controlled with proper disclosure. Referral/Finder Fee Arrangements should be disclosed. If an adviser owns an interest in a business or investment vehicle, the client must be aware of such before investing. Be wary of “exclusive” referral arrangements—an adviser should provide multiple options for service provider referrals.
- Celebrities and athletes should conduct appropriate due diligence on each service provider which may include a questionnaire, license check, google search and separate service agreement. See the next slide for a list of questions you should ask a financial adviser or asset manager prior to hiring him or her to manage you or your client’s money.
Service Provider Due Diligence

Each service provider should pass a baseline due diligence test prior to engagement. The attorney can play a front-line role in assisting the client to conduct such due diligence. Appropriate questions may include:

- Provide a detailed list of each service for which you are agreeing to provide and the fee associated with such service.
- Provide at least two service providers for any service for which you are not taking primary responsibility and describe your relationship with such provider, including any fee sharing arrangements.
- Request a list from each provider stating current licenses, college degree, list of employers and years of experience; Do a Google search looking for lawsuits, complaints, negative press.
- Are you registered with any regulatory authority? Have you ever been disciplined by any regulator, sued by a regulator or sued by a client?
- For financial advisers or fund managers you want to know if they are registered with the SEC and/or FINRA; whether they will receive a commission for the sale of any financial products to the client; and you can conduct an “adviser check” at [http://www.adviserinfo.sec.gov/IAPD/Content/Search/iapd_Search.aspx](http://www.adviserinfo.sec.gov/IAPD/Content/Search/iapd_Search.aspx) to verify the adviser is licensed and to review any disciplinary information.
- CPAs are regulated by their state’s Board of Accountancy.
- Sports Agents generally are required to register with the player association of the respective sport (NFLPA, etc.)
- Talent Agents are required to be licensed in CA under the California Labor Code and there are currently questions regarding whether personal managers and even attorneys must register as talent agents or risk forfeiture of payment by the client.
- Private fund managers typically have a Due Diligence Questionnaire completed for their form (DDQ). You can provide them a template to complete as well. I can provide one to you upon request.
Tax and Estate Planning and Structuring

In this presentation I defer to my esteemed colleagues on tax planning and structuring matters. However, here are a few points to consider when drafting trust documents:

- Trustees have certain duties, which can provide the beneficiary some protection from undisclosed and inappropriate conflicts of interest. See e.g. California Probate Code, §16052.

- As investment advisers rethink the wisdom of Modern Portfolio Theory, or the client wishes to hold specific assets in the trust, it may be prudent to modify the trust documents to limit the duty to diversify investments. See e.g. Uniform Prudent Investor Act, California Probate Code §§16002(a), 16003, 16045-16054.

- Be careful regarding overly complex structuring, and that your financial team is on-board with proposed structures. If your team members are not working together, structural conflicts can arise. Some cases of potential overly complex structuring I’ve encountered include: Private Annuities; Basket Options and Annuity Wrapped Hedge Funds.

- In tax planning, be cognizant that if you are not making money, you are not paying taxes (with some exceptions). Some clients get so caught up in saving on taxes, they trap themselves in low-yielding underperforming investments.
Case Study Planning Considerations

We will look at general planning considerations for athletes and entertainers below but first I would like to address the case studies and specific concerns raised.

- Tariq’s contract has $30mm guaranteed salary which may be paid as a signing bonus, salary or deferred compensation.
- The decision to defer income is tricky because the CBA stated present value Discount Rate is set at the 1-year Treasury Yield.
- State residency laws may affect whether signing bonus is taxed in the state in which the team resides or state in which player claims residency. The Bellaire mansion may not have been the best choice, depending on the amount of time he actually spends in CA.
- One consideration may be to transfer part of the signing bonus to a CRT, CLT, CRUT or Gift or Private Annuity.
- Set up separate holding company for each non-team income stream, preferably in a state with no income tax. To the extent income is generated from such revenue streams internationally, consider setting up an offshore holding company to mitigate risk from onshore creditors. As with Tariq above, we should first determine Juston’s citizenship and residency status in order to develop an onshore and offshore financial and asset protection plan.
- Each income stream (publishing/IP, record royalties, touring/merch. etc.) should held by separate holding companies, in addition to a separate family master trust or LLC to hold entity shares and investment holdings.
- Each entity can have its own specific insurance policy to cover risks such as IP infringement; touring general liability, general business liability, and also an umbrella liability policy.
- Confidentiality/NDA agreements should be executed with each Business Team member and business partner.
NFL Income Basics

- An NFL player’s employment in the NFL is subject to the NFL August 4, 2011 Collective Bargaining Agreement between the league and NFLPA.
- Player income (salary, signing bonus and OTA payments) is treated as employee (W-2) income and subject to state and federal tax withholding.
- State income taxes are due where earned and tax filings must be done for each state in which the income is earned. Games played in Canada or England will require additional foreign tax filings. Some cities also require tax withholding.
- Players are not allowed to accept player salary or signing bonus income through a holding company; however, endorsement or non-team related income should be set up to flow through a S Corp., multiple S Corps. or possibly through a S Corp. Grantor Trust. I typically recommend each income stream has its own segregated holding company to mitigate cross-collateralization of potential liability. Doing so in a state without state income tax can help mitigate taxes.
- Player contract salary information is shared with all NFL teams and is often leaked to the public, so keeping income related information private is difficult.
Financial planning and budgeting is crucial with the client’s wealth management, accounting and legal team (“Business Team”) working together.

- Since Tariq has multiple children from multiple mothers the Business Team should work together to negotiate child support payment terms and possibly try to get current partner to sign a common law marriage waiver/relationship agreement. Staying current on support payments is critical since delinquency can lead to jail and voiding of his NFL contract.
- Support trusts can be set up to provide auto-payment of negotiated child support payments. Business manager/accountant can set up auto-payment plans for regular expenses with a set amount of discretionary spending going into personal account monthly—this can force the client to “think before he spends.”
- Educate client on the general 4-3-2-1 “rule”: 40% goes to taxes, 30% goes to household budget and family support; 20% should be saved and invested, whether in taxable or tax-deferred retirement accounts; and 10% is for discretionary spending.
- Budget should set limits for family and entourage support—appoint a gatekeeper to handle financial support, and investment or business opportunity requests, etc. In other words, don’t put the client in the position of having to “say no.”
- Tariq should purchase a significant umbrella liability policy above his homeowners policy, including one that protects him when friends drive his vehicles. Many states have laws that place liability on vehicle owners in addition to drivers.
- Juston seems to be focused on income smoothing and planning techniques. The Business Team and investment advisers should have a strong working knowledge in music industry income streams in order to effectively budget estimated publishing income and other royalties, and to be able to properly value such royalties in case a sale could be negotiated. Yield is hard to come by currently so it’s also important that realistic income projections are build into the financial plan.
In addition to the entity structuring considerations, below are some additional considerations to protect privacy and confidentiality of HNW clients:

- Confidentiality/NDA agreements should be executed with each Business Team member and business partners.
- Use unique titles for business holding companies and trust entities. Form such entities in jurisdictions that protect the identity of trustees and beneficiaries.
- Limit access to business documents to trusted advisers and hold documents on a secure cloud server or in a bank deposit safe.
- Hire a cyber security firm to set up a secure encrypted server with at rest and file transfer encryption; encrypt phone and tablet devices and use password protection.
- Net worth aggregation services such as Mint can be used to allow the client general access to financial accounts without risking disclosure of account details.
- Holding offshore assets in an offshore jurisdiction like the Bahamas or Nevis/St. Kitts can help mitigate liability because such jurisdictions typically it more difficult for U.S. creditors to get to the assets. For example, they may not recognize foreign judgments, require separate action in the jurisdiction, require a significant bond for fees and costs, etc.
- Non-U.S. Citizens are typically not required to disclose all foreign financial accounts. If Tariq or Juston are Canadian, he may be able to hide offshore accounts and pay no income tax on offshore accounts or assets. Canada taxes income based on residency. Tariq could, for example, purchase a property in Nevis for more than $400k and apply for dual Canada/Nevis Citizenship (Nevis has a Citizenship purchase program).
- U.S. Citizen FBAR filings are likely discoverable in a lawsuit.
Confidentiality and Privacy - Family Office Structure

HNW clients with more than $25mm of net worth may consider setting up his own family office team to internally management investments through his holding companies and trust structures. A single family office adviser has the following benefits:

- Family Office advisers do not need to be registered with the SEC or states which can help maintain confidentiality.
- Investments can be made through private partnerships (single LP fund structure), LLC entities, and trusts to create a private fund of funds or single LP PE/VC fund. In addition, privately negotiated separate managed accounts can be set up to manage liquid investments, possibly even utilizing a dark pool structure.
- Family office manager can act as gatekeeper to manage information flow and manage service provider relationships with lawyers, accountants, administrators and portfolio managers.
- U.S. based investment advisers generally must register as investment advisers in foreign jurisdictions. A single family office manager may not need such registration to advise on offshore assets.
Financial and Retirement Planning

Financial Planning/Retirement Planning go hand in hand with cash flow planning and budgeting and must work in concert. Key inputs into a well-built financial plan include:

- Current and future income and expense, cash flow assumptions and lifestyle expectations vs. long-term income and expense realities.
- Expected length of primary and secondary career or income sources.
- Family expenses/support.
- Expected length of retirement.
- Retirement income sources (part time job, family trust/inheritance income, royalties/residuals, retirement plan/pension, investments, social security, etc.).
- Investment portfolio risk/return characteristics.
- Tax planning for state and federal taxes.
- Retirement lifestyle and income expectations.
- College education planning for kids.
- Healthcare and insurance costs and benefits
- Charitable and gift goals.
- Wealth transfer/estate planning goals.
Sophisticated financial planning software can take the data inputs and create financial plan scenarios that will allow the advisor and client to make critical assumption adjustment in order to predict the success allowing the client to live a long retirement within his or her expected financial means. However, it’s critical to monitor these key aspects of the client’s financial plan and make needed adjustments to assumptions:

• One, three and five-year income and expense assumptions.
• One, three and five-year rolling average expenses.
• Liquidity and leverage ratios. Liquidity Ratio is the ratio of liquid to illiquid assets owned, so if an investor has a $5,000,000 portfolio, but can only access $500,000 in the short term, the ratio is 10%. For most investors with less than $10MM in net worth, we recommend a liquidity ratio of more than 50%. Leverage Ratio is the ratio debt to equity in an investment portfolio, so if an investor has $500,000 to invest, takes out a margin loan of $1,000,000 and buys $1,500,000 in securities, the leverage ratio is 3:1. Taking out a securities loan to pay for current expenses increases the leverage ratio.
• One, three and five-year rolling average net investment return within risk/return buckets, and after tax net return (see below).
• Changes in life circumstances such as marriage or divorce, raising kids, change of job or career, unexpected income or expenses, health concerns, family support, etc.
• Changes in input assumptions and lifestyle expectations (maybe the client realized she doesn’t really need a third vacation castle in the South of France).
Investment Planning and Structuring

Investment planning and structuring covers many facets and is integrally integrated with your:

- Current cash flow, budgeting and income requirements;
- Investment risk and return goals and expectations;
- Asset protection needs;
- Retirement goals, objectives and income requirements;
- Estate and tax planning goals
- Liquidity needs;
- Charitable giving objectives;
- Understanding and level of sophistication with various investment vehicles, strategies and styles; and
- Fraud protection and due diligence resources.
The first step is to marry the investor’s investment plan with this current risk and return objectives and financial plan. Some advisors recommend in certain circumstances that the client set up multiple risk/return portfolios based upon the client’s financial planning objectives and expected income horizons. For example:

- Early in a client’s career, she may have more tolerance for risk and willing to accept the possibility of larger drawdowns when income is high. At this point in the financial plan, the advisor may recommend a more aggressive risk/return portfolio with higher volatility. The client and advisor must still be careful to manage drawdowns, which if significant, can dramatically affect the long-term cash flow and income assumptions in the financial plan.

- As the client continues down the life spectrum, a more moderate risk/return portfolio combining growth and income can be constructed. It’s important to understand that risk tolerance and objectives change over time. An investor nearing retirement simply can’t absorb a 30% portfolio decline which may take a decade or more to recover.

- A separate long-term capital preservation portfolio can be constructed to ensure the client has a baseline portfolio of investments from which to draw income in the future. As bond yields increase over the next ten years (an assumption), a laddered investment-grade bond portfolio can be an effective option for this purpose.

- In addition, the financial plan may indicate a percentage of the portfolio hold private alternative investments like private equity, hedge funds, commodities or derivatives, which may hive a higher risk/return profile with limited liquidity. See below for a more detailed discussion on alternative investments and recommended portfolio percentages based on a client’s net worth and objectives. For clients with less than $2m of investable assets, the availability of quality private investments is scarce without placing the client in high liquidity risk (since most private fund managers require minimum investment of $1-5m).
A typical investor’s portfolio may be comprised of a myriad of investment vehicles, many of which are not fully understood. Below is a nutshell discussion of types of investments common in a sophisticated investment portfolio.

Traditional Liquid Investments:
- **Stocks**: Represents fractional ownership in a public company
- **Bonds**: Represent a debt obligation of a company or government
- **Mutual Funds**: Actively managed basket of investments typically within a particular asset class (Large Cap US Equity; International Bonds, etc.)
- **Index ETFs**: Passively managed basket of investments designed to track a particular index

Alternative Investments:
- **Derivatives**: Derivative Contracts such as options, futures and swaps which derive their value from the performance on an underlying investment or market and are typically leveraged by a factor of 3x or more
- **Actively Managed/Alt. ETFs**: Managed with alternative or inverse investment strategies
- **Real Estate**: Can be direct real estate investment, REIT or 3(c)(5) or other private fund
- **Hedge Funds**: Private investment limited partnerships managed by a professional investment manager. There are many types and styles as discussed below
- **Private Equity/Venture Capital**: Private investment funds which invest in private companies
Investment Strategies and Structures

An investor may choose a number of investment strategies or styles in which to manage his or her investment portfolio, some of which may include:

Fundamental Analysis

- Fundamental Analysis ("FA") is old fashioned investment selection—the stock pickers like Warren Buffett. Investors conduct detailed information gathering and analysis regarding a company’s financial strength by analyzing the financial statements, dividend history, management, corporate news releases and analyst reports in order to pick stocks or bonds to hold in his or her portfolio.
- FA portfolios tend to be “buy and hold” long-term investment strategies and more tax-efficient than other investment strategies.
- FA investors can use dollar-cost averaging and laddering strategies to make shorter term buy and sell decisions.
- FA is heavily dependent on the investor’s financial skill and resources to choose the right stocks and bonds. Often decisions are made based upon the investor’s “gut instincts” about the value and future prospects of a company.
- As equities markets correlate due to high frequency trading and the availability of information processing, the stock markets (at the investment level) are becoming more and more efficient, which means that the opportunity to find inefficiencies and make profits is less.
Strategic Asset Allocation

- Strategic Asset Allocation (“SAA”) is a portfolio strategy that generally involves setting broad global asset allocations to a set percentage within each asset class, then periodically rebalancing the portfolio back to such set asset class allocation percentages.
- A typical SAA portfolio may set a top tier allocation to equities and bonds to 60%/40% respectively for a “moderate risk” client, then may divvy up the equities portion amongst different classes—Large Cap US, Small Cap US, Large Cap Intl., Emerging Market, etc.; often using index ETFs, sector ETFs and mutual funds to gain exposure to asset classes.
- HNW clients using SAA may buy and sell individual stocks and bonds in order to create their own private index funds for tax efficiency and cost purposes.
- The key is that once the allocation targets are set, it’s a “Set It and Forget It” strategy regardless of market conditions, with adjustments made only to periodically reset allocations to the targets.
- SAA became popular as a result of the general acceptance of Modern Portfolio Theory developed in the 1950’s by Harry Markowitz, and generally assumes a portfolio can achieve optimum risk/return through broad diversification.
- SAA portfolios tended to do well in the market cycle we’ve been in since the 1980s as the equity markets grew and interest rates declined. With declining interest rates the negative correlations between equities and fixed income generally held, making bonds the “safe” or “risk-off” part of the portfolio with equities holding the “risk-on” allocation. This may not hold as interest rates increase and bond prices decline.
Tactical Asset Allocation

- Tactical Asset Allocation ("TAA") is similar to SAA except it provides the portfolio manager or investor some discretion to adjust target asset allocations within a set range as market conditions fluctuate.
- For example a moderate risk client may hold 60% Equities and 40% Fixed Income in a "normal market" but the allocation may be adjusted to a 50%/50% allocation in a bear market.
- I’m defining TAA to include strategies in which the portfolio manager or investor generally use personal discretion in order to reset target allocations within the stated acceptable ranges, based upon the portfolio manager’s analysis, research or gut instincts regarding future market conditions. (See Dynamic Asset Allocation below for rules-based asset allocation).
- Although the percentage allocation to asset classes may change over time, TAA portfolios typically hold such assets consistently with only minor adjustments and maintain broad global diversification.
Dynamic Asset Allocation

Dynamic Asset Allocation (“DAA”) is a subset of TAA and is an emerging portfolio strategy which employs sophisticated technical and/or quantitative modeling to set asset allocation targets.

In other words, the discretion to make asset allocation adjustments is taken out of the investor’s or portfolio manager’s hands and set using rules-based filters derived from technical indicators and/or mathematical algorithms to identify market inefficiencies. The manager is responsible for developing the trading rules and algorithms that can identify which assets or asset classes will perform well in all market conditions. The investment adviser also helps combine various strategies and managers.

As such, an important consideration in any quantitative or active strategy is signal/filter integrity, meaning that the filters are consistently and accurately applied from inception and the manager does not panic and make emotional reactive trading decisions when volatility goes up. Either the strategy works or it doesn’t.

DAA strategies have only become viable for retail investors in the past few years due to advances in trading and modeling technology that allow investors to develop complex trading rules and manage portfolio trading across multiple accounts.

DAA strategies tend to set target allocation ranges for asset classes, but the range may be much broader than TAA and can go from 0% to 100% in highly volatile markets (0% for highly underperforming “risk-on” assets and 100% for cash position).

DAA Portfolio strategies may use a “universe” of asset classes in which the portfolio may invest, but will typically not hold all available assets if such are underperforming—so if the universe has 30 available asset classes, the portfolio may only hold 20 at any given time. For example, in 2013-2014 a DAA portfolio may not have held gold or other commodities and may have over-weighted to US equites and treasuries. In 2014-2015 oil/energy would be underweighted or out of the portfolio.
Investment Strategies and Structures

Dynamic Asset Allocation, Cont.

- DAA managers typically use a variety of technical and trend following indicators such as time-series momentum, cross-sectional momentum or relative strength, mean reversion, pullback/breakout or a combination of these and other indicators to develop a proprietary mathematical trading algorithm.

- Single filter/signal and high volume trading strategies, and the use of leverage, can mean high volatility/risk for these strategies, but top DAA managers with diversified filters tend to have success limiting drawdowns in bear markets like 2008 while maintaining good upside capture in bull markets. As we enter into a rising interest rate environment, DAA portfolios may tend to outperform SAA and TAA portfolios as bonds shift to a “risk-on” investment.

- Sophisticated DAA managers may employ filters at multiple levels. For example Blue Sky Asset Management (BSAM, our affiliated DAA manager) applies a dual cross-sectional and time-series momentum filter, first on the Global Macro level in order to determine if a portfolio is “offensive” or “defensive” and what the offensive/defensive ratio should be. A key observation is that some asset classes can behave offensively in one market cycle, while defensively in other market cycles; gold, currencies, and to some extent U.S. Treasuries are good examples. The manager/strategy should take this into account once determining a portfolio should be offensive or defensive before the filters set allocation targets to asset classes within the portfolio.

- The BSAM strategies then apply the cross-sectional and time-series momentum filters at the asset class level, actively shifting asset classes from poor performers to higher performers, and can go to high cash equivalent concentrations in highly correlated bear markets.
Hedge Funds

- Hedge funds are private investment funds often structured as limited partnerships. They are not registered as an investment company under the Investment Company Act and are therefore generally not subject to the investment restrictions imposed on mutual funds with respect to diversification and leverage, and do not require an independent board of directors.
- Strategies include: Global Macro, Long/Short Equity, Quantitative/Statistical Arbitrage, Merger Arbitrage, Multi-Strategy, Fund of Funds, Asset-Backed Lending/Real Estate Mortgage, Event Driven/Information Arbitrage, High Frequency Trading/Exchange Arbitrage, Short Only, etc. (Note that the DAA managers above use similar techniques to the Quantitative/Statistical Arbitrage managers, but do so outside of a hedge fund structure).
- Hedge funds have unique risks including: lack of liquidity (hedge fund typically have limited redemption rights and managers can freeze redemptions); lack of transparency/asset custody (the fund owns and trades underlying securities, not the investor; the manager may not be required to disclose underlying investments or transaction information); manager fraud (Bernie Madoff, Tom Petters, etc.); high investment minimums; investment concentration and leverage, and the possibility of total loss of principal. Even some top notch hedge fund and private equity managers lost 50%+ in 2008.
- Hedge funds typically charge high fees, typically a 2% management fee and 20% performance fee/carried interest. However, investors should be more concerned with the net return after taking fees and costs into consideration.
- Most large fund managers are now required to register as an investment adviser with the SEC. If the manager has under $150mm in asset under management, it may or may not be required to register with their state division of securities as an investment adviser. It’s important to conduct appropriate due diligence on the fund manager and strategy prior to making an investment. How to appropriately conduct due diligence on private fund managers is beyond the scope of this presentation and a complex process that requires years of experience.
Investment Strategies and Structures

Private Equity and Venture Capital

- Private Equity and Venture Capital (PE/VC) strategies are types of hedge fund structures that focus on active investment and management in closely held companies, start-ups and distressed companies.
- PE/VC funds are typically only available to HNW investors with $5mm to invest, and have long-term investment periods requiring a 5-year minimum lockup. As such, the investor/client must have sufficient liquidity in the remainder of her investment portfolio assets to justify such a long-term illiquid investment.
- PE/VC tend to be high risk/high reward investments with target net returns of 15-20%+ per year. Fund managers typically management fees of 2%+ and carried interest (performance fee) of 20%+.
- As with other private alternative investments, appropriate due diligence on the manager is crucial. Key considerations include: principal background; audited financial statements; portfolio company and fund IRR track record; portfolio company investment criteria and concentrations (number of portfolio companies, style, industry, and geography); transparency; RIA registration; internal or independent administration, etc.
- Although private equity fund managers must register with the SEC as an investment adviser, VC fund managers do not. Of course, it can be difficult to distinguish the two and conducting due diligence on unregistered entities may be more difficult.
Investment Strategies and Structures

Other investment strategies and products commonly pitched to athletes and entertainers include:

- **Franchises**: a franchise is a privately owned business which licenses the trademark and various levels of business and management process or products from a franchisor organization. Franchise agreements can involve a high degree of input, guidance, operations and product control and training from the franchisor, or very little.
  - The key is to understand that that the franchisee is primarily responsible for running the business, buying/leasing land, building and maintaining fixtures, hiring management and employees and profitability.
  - The Franchisee pays a franchise fee and ongoing royalties to the franchisor as a percentage of revenues. Often shared advertising is also charged.
  - Without experienced management, internal controls, a winning business model, and lots of happy customers, a franchise can fail just like any other business. Start up costs can be significant, especially for hotel, restaurant or other facility heavy businesses.

- **Premium Financed Annuities & Life (PFAL)**: PFAL products are insurance annuity products in which the annuitant takes a loan to pay the premium, and it’s assumed the investment portfolio will generate enough cash flow to pay ongoing premium payments and fund the benefit. PFA product salesmen present clients with complex spreadsheets showing how the investor can receive high tax free income payments for no money out of pocket. Of course, such products have significant risk and, unlike often recommended by the PFAL companies, absolutely should not be used to manage a client’s entire wealth management portfolio. As an annuitant, the investor only owns the insurance contract, not the underlying investments, and often has little control over the invested portfolio. If the manager fails to produce sufficient returns, the annuitant can be forced to replenish the contract or benefits could be lost. For UHNW clients, such contracts if used in moderation can provide some estate tax benefits.
U.S. Citizens Investing Offshore

- ERISA Pension and Retirement Plans can use offshore feeder funds to wash U.S. investment Unrelated Business Taxable Income (UBTI) and Effectively Connected Income (ECI)
- Onshore Private REIT can be used for same purpose for certain real estate investments
- U.S. Investors may invest through an offshore jurisdiction or entity to gain access to foreign investments unavailable through U.S. markets
- U.S. Investors may invest through an offshore jurisdiction or entity to seek to keep such investments confidential for privacy, asset protection or other goals
- U.S. Investors may invest through an offshore jurisdiction or entity to shield such investments from U.S. or other offshore creditors
- Dual citizens may hold investments in multiple jurisdictions for income tax and other reasons
- In some jurisdictions, such as Mexico, foreign citizens can own real estate only through a trust or other entity in such jurisdiction
U.S. Tax Exempt Investors

- U.S. based hedge funds serving ERISA pension plans and other tax-exempt organization have long used offshore master-feeder structures in order to protect tax-exempt investor accounts from UBTI and ECI, which can wreak havoc on the tax deferral status of such accounts.
- Cayman Islands, Bahamas, and BVI have traditionally been the most popular jurisdiction for such structures.
U.S. Investor Reporting


- A United States person that has a financial interest in or signature authority over foreign financial accounts must file an FBAR if the aggregate value of the foreign financial accounts exceeds $10,000 at any time during the calendar year.
- A financial account includes, but is not limited to, a securities, brokerage, savings, demand, checking, deposit, time deposit, or other account maintained with a financial institution (or other person performing the services of a financial institution). A financial account also includes a commodity futures or options account, an insurance policy with a cash value (such as a whole life insurance policy), an annuity policy with a cash value, and shares in a mutual fund or similar pooled fund (i.e., a fund that is available to the general public with a regular net asset value determination and regular redemptions).
- Generally, a child is responsible for filing his or her own FBAR report. If a child cannot file his or her own FBAR for any reason, such as age, the child’s parent, guardian, or other legally responsible person must file it for the child.
Financial Interest for FBAR Purposes is Defined as: A United States person has a financial interest in a foreign financial account for which:

1. the United States person is the owner of record or holder of legal title, regardless of whether the account is maintained for the benefit of the United States person or for the benefit of another person; or
2. the owner of record or holder of legal title is one of the following:
   a. An agent, nominee, attorney, or a person acting in some other capacity on behalf of the United States person with respect to the account;
   b. A corporation in which the United States person owns directly or indirectly: (i) more than 50 percent of the total value of shares of stock or (ii) more than 50 percent of the voting power of all shares of stock;
   c. A partnership in which the United States person owns directly or indirectly: (i) an interest in more than 50 percent of the partnership's profits (e.g., distributive share of partnership income taking into account any special allocation agreement) or (ii) an interest in more than 50 percent of the partnership capital;
   d. A trust of which the United States person: (i) is the trust grantor and (ii) has an ownership interest in the trust for United States federal tax purposes. See 26 U.S.C. sections 671-679 to determine if a grantor has an ownership interest in a trust;
   e. A trust in which the United States person has a greater than 50 percent present beneficial interest in the assets or income of the trust for the calendar year; or
   f. Any other entity in which the United States person owns directly or indirectly more than 50 percent of the voting power, total value of equity interest or assets, or interest in profits.
FBAR Cont.

- **IRA Owners and Beneficiaries.** An owner or beneficiary of an IRA is not required to report a foreign financial account held in the IRA.

- **Trust Beneficiaries.** A trust beneficiary with a financial interest described in section (2)(e) of the financial interest definition is not required to report the trust's foreign financial accounts on an FBAR if the trust, trustee of the trust, or agent of the trust: (1) is a United States person and (2) files an FBAR disclosing the trust's foreign financial accounts.
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