HILLIARD LYONS TRUST

A Baird Company

Newsletter | July 2021

Mark K. Nickel, CFP®
President
Chief Investment Officer

As we announced weeks back, we are excited to be rebranding Hilliard Lyons Trust – A Baird Company – to Baird Trust, effective September 30, 2021. With plenty of work taking place behind the scenes as we prepare for the rebrand, we wanted to share an update on where we're at in the process and share a little bit of the back story of how we got here.

Why We're Rebranding

While Hilliard Lyons Trust has a tremendous legacy and strong roots within the communities we serve, by rebranding as Baird Trust, it will enable us to better serve the evolving needs of our clients, while also aligning more closely with the Baird brand. This is an important step as we continue to grow alongside Baird's extensive network of Private Wealth Management offices, which spans more than 160 offices in 33 states. And because Baird is privately held and employee-owned with minimal leverage, we can remain focused on your needs, free from the potentially competing interests of outside shareholders.

New Name and Brand. Same Company and High-Quality Service.

Introducing the new Baird Trust logo:

BAIRD TRUST

Although we're getting a new name and brand, nothing is changing from a personnel, management or location standpoint. In fact, we're thoughtfully growing our team and increasing our footprint at our Louisville headquarters to ensure we're positioned for future business opportunities. We are committed to continuing the strong relationships we have built in our communities and are eager to build on that legacy as Baird Trust.

Although you will see a new name and brand, we want to assure you that you will continue to receive the same customized, high-quality service that you're accustomed to. We are certainly excited about the new brand and prospects of future growth, but our No. 1 priority remains you. This rebrand doesn't impact any of your existing agreements with us, and in fact, there is nothing you have to do as part of this initiative.

In Summary:

- Rebranding to Baird Trust to better align with Baird and better serve YOU
- Same people and same locations as today, just a new name and brand
- No impact to any of your existing agreements; no action for you to take
- The change will take place on September 30, 2021

The Strength of Baird:

- Privately held and employee-owned
- *Fortune* 100 Best Companies to Work For® – 18th consecutive year on the list
- *Fortune* and Great Place to Work's 2020 Best Workplaces for Women
- Learn more about Baird's awards and accolades on our website – rwbaird.com
- Over 100 years in the business!

Hilliard Lyons Trust Market Commentary

Why all this talk about inflation?

Ross A. Demmerle
Vice President
Equity Analyst

In June, the Ohio amusement park Cedar Point was forced to close its doors to the public for many weekdays because it could not find enough employees to run the park. In response, it raised hourly wages 100% from $10 to $20 and offered a $500 signing bonus. Thrill-seekers were disappointed by fewer operating days and will be even more so if the park chooses to raise prices. Economists refer to this circumstance as wage push inflation. As measured by the Consumer Price Index (CPI), inflation increased at an annualized rate of 5.0% in May. This is a meaningful increase over the average annual 1.75% increase in CPI over the last 10 years. Given recent media headlines, we think clients should have a better understanding of how inflation could impact their investments and why WIN buttons from the 1970s should remain a thing of the past.

Broad-based Inflation Is Evident

Higher inflation is currently most visible in commodities (lumber, steel, copper, oil, grains, etc.) and in wages. But the impact is widespread as the price of gasoline, airfares, hotel rooms and used cars are also increasing rapidly. In recent months, numerous public company management teams emphasized the rising cost of doing business.

There are several drivers behind today's high inflation. Substantial government stimulus and unemployment insurance bolstered personal savings and income over the past 15 months. As consumers emerge from the pandemic with excess cash in their pockets, demand for goods and services is exploding. At the same time, global supply chain disruptions caused by economic shutdowns are reducing the supply of goods available for consumption. One of the first things aspiring economists learn in Econ 101 is that limited supply combined with exploding demand leads to rising prices, sometimes rapidly.

Toward the end of 1974, the federal government instituted a campaign to promote higher levels of personal savings, frugality, decreased consumer spending and energy conservation. Citizens were encouraged to wear a WIN button indicating their support to beat the 11% average inflation harming the nation in 1974.

Will It Be Transitory?

The Federal Reserve believes the current increase in inflation will prove to be "transitory" or not permanent. It very well could be. Many of the drivers of today's higher inflation are due to the pandemic and might be self-correcting. Government assistance will fade in a few months. More people will be incentivized to rejoin the labor force when enhanced unemployment payments come to an end. After a spending spree, personal savings and income should trend toward historical norms. Companies will be able to increase their supply of goods as their ability to source components necessary to make a final product stabilizes. Moreover, the Fed has the ability to raise interest rates to dampen inflation if it proves to linger longer than expected.

Accurate Forecasting Is a Challenge

Still, even professionals have difficulty predicting inflation. Many experts predicted rampant inflation coming out of the 2008-2009 global financial crisis, which never materialized. In June, the Fed raised its 2021 median inflation estimate to 3.4%, nearly double its 1.8% estimate only six months prior in December 2020. Wall Street economists, who have a mixed track record,

think inflation will peak in 2021 and then moderate. Even the most recent University of Michigan survey indicated an inflation outlook of 4.6% over the next year, although consumers also have a weak track record of predictions. For those in the prediction business, the late economist Paul A. Samuelson had some wise words – "If you must forecast, forecast often." With this quip, the Nobel Prize winner recognized his own fallible opinions as well as those of others. In an effort to improve its own accuracy, the Fed changed its 2021 forecast three times over six months, proceeding just as Mr. Samuelson prescribed.

Deflationary Structural Changes

A certain amount of inflation is helpful to the economy. Modestly rising prices are viewed as a positive when it helps boost consumer demand and consumption, driving economic growth. With the caveat that we cannot accurately predict future inflation, we believe several structural changes make a return to the WIN buttons of the 1970s unlikely.

In decades past, the U.S. was more reliant on foreign sources for oil. With the help of hydraulic fracturing, the U.S. became a net energy exporter in 2019, achieving energy independence. An abrupt reduction in petroleum imports, similar to the 1973 oil embargo, would have less impact on oil and gasoline prices as compared to the past. Secondly, the economies and cultures of the world have become more intertwined. Globalization more easily allows production to flow to the lowest-cost geographies, acting as a deflationary force. Finally, with information at our fingertips, the internet has radically increased price transparency for millions of consumers, spurring greater price competition and lower prices across goods and services. Entrepreneurs now have the tools to make an impact more quickly when there is a mismatch between supply and demand.

Our Path Forward

We readily admit our inability to predict the future inflation rate, yet we believe your portfolios are well prepared for the uncertainty ahead. High inflation can wreak havoc on cash and bonds, rapidly eroding their real value. Fortunately, we typically seek to be fully invested with limited excess cash and aim to invest only in high-quality short- and intermediate-term fixed income products. While these instruments are not immune to high inflation, they are less impacted than lower-quality and longer-term fixed income vehicles.

In equities, we seek out well-managed industry-leading companies with sustainable competitive advantages. Because of these advantages, they typically exhibit some degree of pricing power, which allows them to increase prices as input costs rise. During periods of high inflation, businesses with pricing power are often less impacted than businesses without pricing power.

Our investment philosophy is to think and act like long-term business owners. Because our intention is to own businesses for long periods of time, we must acknowledge up front that many uncertainties will arise that we cannot predict. Over any five- to ten-year period, there could be recessions, trade wars, deflation or high inflation. We focus on investing in businesses that can manage through many different environments, including the elevated inflation we see today. Regardless of the inevitable price changes ahead, we strongly believe the best path forward is to stick to our time-tested process and focus on the long-term compounding of your wealth.

Thank you for your relationship with Hilliard Lyons Trust. We appreciate the confidence you place in us as stewards of your financial assets. Our ultimate goal is to serve your needs and grow your wealth over time.

The Important and Complex Role of the Trustee

Lucie Brooks, JD, CTFA
Vice President
Trust Officer

How does a trustee decide to make distributions to a trust beneficiary? This is often the first question clients have when they are considering leaving wealth in trust for their spouse or a future generation, and many factors impact the answer. Trustees primarily look to the terms of the trust to guide consideration of distribution requests from beneficiaries. Yet trust documents rarely account for every conceivable circumstance in providing guidance. Trustees also rely greatly on their experience and a disciplined process in deciding whether a particular request is permissible and prudent.

In approaching this decision-making process, trustees are bound by certain fiduciary duties. Two of the most important are the duty of loyalty and duty of impartiality. A trustee's duty of loyalty requires that they administer the trust solely in the interest of the beneficiaries, while the duty of impartiality requires the trustee to manage the trust considering the interests of all trust beneficiaries. Both duties shape a trustee's thought process when considering a beneficiary's request for a distribution.

Current beneficiaries, as one might expect, are entitled to current distributions from the trust, and there can be multiple current beneficiaries with differing distribution privileges. Future beneficiaries, commonly referred to as remainder beneficiaries, are the beneficiaries who will benefit from the trust at the end of a certain time, most often the passing of the current beneficiary. A trustee must consider the interests of both. Although remainder beneficiaries have no current right to distributions, trustees must consider their potential future needs when evaluating a distribution request from a current beneficiary.

A common scenario involving multiple current beneficiaries occurs when a spouse creates a trust for their surviving spouse and their children. In these cases, the surviving spouse is often the "primary" beneficiary entitled to the trust income and additional distributions as the trust document might outline. While the surviving spouse is the primary beneficiary, the children are also entitled to distributions at the trustee's discretion.

This situation often isn't complicated while the children are minors in the care of the surviving spouse, but as children begin careers or start their own families, their interests and needs may diverge from the surviving parent. It is common in these instances for a child to make a distribution request from the trustee to cover their own unique financial needs. In deciding whether to make the distribution, the trustee must consider the terms of the trust document as well as the impact this distribution might have on the trustee's ability to provide for other current beneficiaries (the surviving parent or sibling) as well as future remainder beneficiaries. It is important that trustees consider the size of a distribution request in the context of the total trust in evaluating this impact. Relatively small distributions from larger trusts will likely have little to no impact on other beneficiaries, but larger distributions from smaller trusts could significantly impact the trustee's ability to provide for all the beneficiaries.

At the core of every trust is a desire to ensure the financial needs of the trust's beneficiaries are met. Trustees consider each request based on the trust's terms and the specifics of the beneficiary's request. Trustees base their decisions on their responsibilities owed to the trust and the trust's various beneficiaries. Ultimately, individuals create trusts for a variety of purposes and a trustee ensures those purposes, including distributions, are carried out for the term of the trust.

Service Spotlight – Portfolio Management

Gail Burke Tway, CFP®
Director of Portfolio Management

For more than 30 years, Hilliard Lyons Trust has helped high-net-worth individuals, families and institutional clients protect, grow and transfer wealth in a way that reflects their values and vision for the future. With more than $16 billion in client assets, our team includes highly skilled in-house equity and fixed income portfolio managers who customize portfolios to meet our clients' needs. All decisions are made within Hilliard Lyons Trust, and we do not employ outside money managers or investment advisors.

That means that Gail Burke Tway, CFP®, plays a critical role within the trust company as its Director of Portfolio Management. We asked Gail to give us a deeper dive into Hilliard Lyons Trust investment management and discuss what makes HLT different from other trust companies in its approach to its clients.

How long have you worked at Hilliard Lyons Trust?

I first joined Hilliard Lyons back in 1990 after earning degrees in economics and psychology. I started as a financial consultant before leaving Hilliard Lyons to enter the trust business with another firm. Hilliard Lyons Trust then hired me back, and I've been in my current position as Director of Portfolio Management for four years now.

What are your responsibilities as Director of Portfolio Management?

My responsibility is to manage the portfolio management staff and to help make sure that our accounts take advantage of our best ideas. In addition to my people management responsibilities, I also manage client accounts, as does Mark Nickel, our president, and Don Asfahl, our chairman. Don, Mark and I feel it's important for us to continue managing portfolios to keep our focus on what clients want and what the portfolio managers are dealing with on a day-to-day basis. I really love working with clients and don't want to give that up.

What does a portfolio manager do for his or her clients?

The portfolio managers' role is to assist clients in meeting their financial objectives by putting together portfolios that are appropriately allocated based on the clients' needs, risk tolerance, time horizon and return objective. If a trust is involved, we also need to structure the investments in a manner that meets the requirements and objectives of the trust. When we construct an asset allocation, we're mindful of what helps clients sleep at night. We structure portfolios for good and bad markets. If you set someone's risk tolerance too high, you really find that out when markets decline. The time period that it takes to recover from a recession has historically been about 18 months, with the longest time period being about five years. I'll look at a client's annual spending and aim for – between cash, dividends, interest and their bond portfolio – at least five years of living expenses in structured types of investments that are going to perform better in down markets.

What is your typical day like?

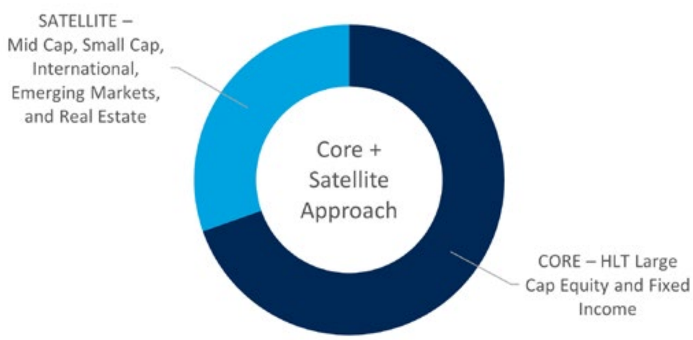
It's always different, because every client is different. Even though the structure of our portfolios have certain guidelines and approved securities, all our portfolios look different from person to person. We don't take a cookie-cutter approach.

I'll have several client meetings during the week, and I'll prepare for them by reviewing their accounts and being aware of what's going on in the financial news. The investment professionals and research staff meet twice a week, going over names in the portfolios and talking about asset allocation. There's a little bit of compliance work every day, making sure accounts are in line with their objectives. Acting as the portfolio managers' manager, I try to touch base with the team at least once a week, making sure they have the resources they need to excel at their jobs. And there are always daily client calls and trading within the accounts.

What's the basic investment approach for trust company clients?

We use what we call the Core + Satellite approach. Core refers to the individual securities we use for our clients' large-cap exposure, and we use individual bonds where it's appropriate to do so. We will use mutual funds and ETFs for the minor asset classes, which we refer to as satellites, including exposure to international investments, emerging markets and small-cap stocks.

There's been a push lately for managers to use mutual funds and SMAs in individual portfolios, but those are really not very tax-efficient. It's important to focus not just on selecting good quality investments, but also to manage in a very tax-efficient way.



What kind of time horizons do your clients usually have?

When we buy a security, we're thinking of owning it for the long term, like a business owner. Even though our investment results have been excellent, I think clients do themselves a disservice when they look at the investment returns quarter to quarter. We talk about managing your investments through full business cycles. If you set expectations appropriately, everyone makes better decisions.

That philosophy fits in with the longevity shown by the trust company itself.

We have an incredible research team, and we are very fortunate that Andy Means has headed up that team for over 25 years. That kind of long-term consistency is really unique in the industry. Our associates have an average of 23 years of industry experience and 13 years with the trust company. When people come to work at the trust company, they stay at the trust company.

What role does the Investment Policy Statement play for your clients?

You can meet with a client, take great notes and think you're all on the same page, and then when you send your portfolio plan to them, they say, "Oh, I thought we were 60-40 stocks to bonds, not 40-60." The Investment Policy Statement spells all that out and serves as a good roadmap for the account. It also reinforces that we're all on the same page as far as investment time horizons or special restrictions. And we're constantly updating it. I've had clients worry that once you fill out that IPS, that's the way we're going to manage your money for the rest of their lives, and the truth is that it's a living, breathing document.

How is your role affected by your status as a fiduciary for your clients?

Acting as a fiduciary means that you put your clients' interests ahead of your own. A lot of asset managers are not fiduciaries. Everyone at the trust company goes to bed and sleeps soundly at night because we know we're doing what's best for clients. That's been a great thing with joining Baird as well, since one of their core values is "clients first."

What kind of oversight is there on your portfolios?

We are regulated by the Kentucky Department of Finance. We do reviews of portfolios on an annual basis, if not more often, and we internally review portfolios once a month if we see things like cash going over a certain level, or concentrated holdings, or low trade activity. Every manager would have to respond to anything in a client portfolio that's outside the norm. Then all of those are reviewed by our compliance team. We also meet once a quarter with the Hilliard Lyons Trust Risk

Committee. There's a lot of oversight, not just on the portfolio manager, but other risks that there could be for the client, such as keeping their information secure or looking for bonds whose ratings may be deteriorating.

What kind of access do your clients have to you?

We will tell clients to call any one of their team members. We don't want the clients to ever feel like they don't have access to every member of their team. Our financial consultants serve as a quarterback for the team, and we refer to them as the relationship manager. The portfolio managers hop in to assist wherever we are needed and take care of the day-to-day management of the investments. With certain types of trusts, the client will also work very closely with their trust officer. It's a very client-centric approach.

We're going to jump through a lot of hoops to make sure our clients are happy. That's why we continue to grow, and our clients continue to work with us. The ultimate compliment is when they send their friends and family to Hilliard Lyons Trust.

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