WELLS FARGO

INVESTMENT INSTITUTE

ASK THE INSTITUTE

What is full balance sheet investment planning?

When an investor faces a liquidity need, there are several strategies from which to choose. These include using cash, selling assets, borrowing using investments as collateral (securities-based financing), opening a line of credit (LOC), or even deciding not to make the purchase. A *full balance sheet* approach means the investor considers both sides of his or her balance sheet before making financial decisions.

What is liability management?

Liability management involves using debt to meet various liquidity needs, such as buying a home, funding higher education, or paying for a large purchase.

What falls on the liability side of a balance sheet?

An investor's net worth includes assets, such as stocks and bonds, and liabilities. Liabilities could include an outstanding home mortgage, student loan, or LOC.

Instead of selling an asset, an investor may choose to borrow to fund a large immediate expense and pay the money back gradually over time.

June 2019

How can credit work as part of an investment strategy?

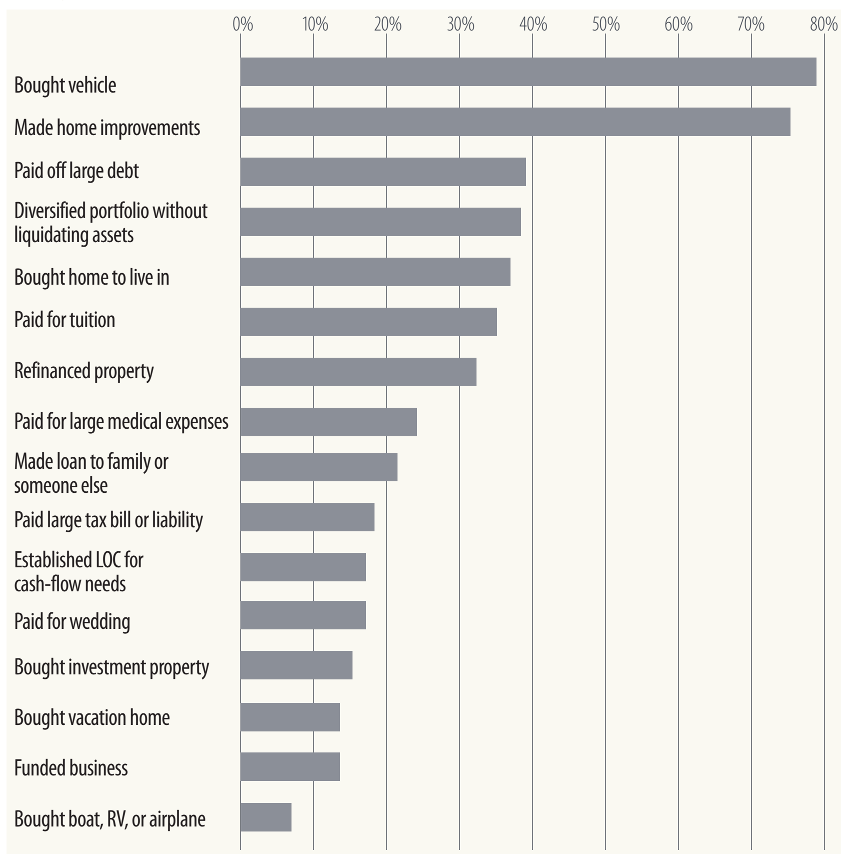
Key takeaways

- When developing a plan to meet long-term financial goals, it can be helpful to consider how you want to invest your assets—and how you may use liabilities.
- Proper liability management and the tactical use of credit may enhance an investor's ability to meet financial goals.
- Incorporating liabilities into an overall financial picture may assist in preserving wealth but also can magnify risk if not prudently managed.

Credit needs have a variety of sources

Asset management is typically top-of-mind for investors; however, a complete investment plan also should include proper liability management. There are many life events that can trigger the need for credit products and services. Wells Fargo research shows that over a five-year span, investors have been faced with numerous liquidity needs that could be addressed using assets, liabilities, or a combination of the two.

Many events have triggered financing needs



Source: *Events Done in the Last Five Years,* Wells Fargo Advisors Lending Behavior Study, December 16, 2016. Percentages reflect survey responses to the question, "Which, if any, of the following have you done in the past five years?"

The importance of understanding liquidity

Liquidity describes the ability to easily gain access to cash. This can be accomplished by selling assets or borrowing. Some assets are considered liquid (such as money market investments or even high-quality stocks and bonds), while others are considered illiquid (such as private equity or personal/commercial real estate).

The appropriate amount of liquidity an investor needs depends on his or her life stage, goals, and risk tolerance. Liabilities can be used as a source of liquidity, especially when selling assets is time-consuming, is costly, or could generate unwanted tax consequences or disrupt an investment plan.

Investors may be able to meet day-to-day liquidity needs with incoming cash flow. This can be in the form of dividends, rental income, or a paycheck. However, investors may have other expenses that require more cash than they have on hand. The graphic below outlines several life events that may require investors to liquidate assets or pursue other funding alternatives.

Liquidity needs differ by life stage

Life stage	Post-college	Working life	Retirement
Possible liquidity needs	• Purchase an automobile • Repay student loans • Purchase a first home	• Start a business • Fund a business expansion • Pay for a child's higher education	• Buy a retirement home • Pay for medical expenses

As these needs arise, investors—with assistance from their financial professional—should consider the following questions:

✔ Do I have enough cash on hand to fund this expense?

✔ If not, do I have enough liquid investment assets to sell without disrupting my investment plan or creating an unwanted tax liability?

✔ If not, should I consider an unsecured loan, or do I have assets that can be used as collateral for my financing?

✔ Is this an appropriate interest-rate environment, and am I comfortable taking on debt to fund these expenses?

✔ Should I consider a combination of liquidating assets and borrowing as a full balance sheet management strategy?

Buckets of liquidity

Investors generally have three *buckets* from which to choose when they need liquidity.

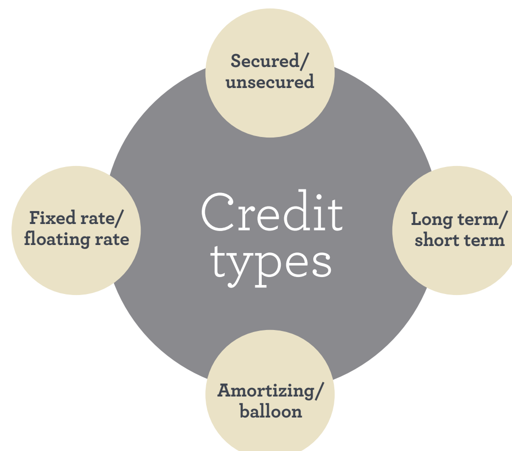
A variety of credit products and services are available

The prudent use of liabilities can assist in funding day-to-day expenses, liquidity events, and investment portfolio enhancements, potentially resulting in a higher chance of achieving long-term financial goals. It also can help investors maintain their investment strategy while meeting unexpected liquidity needs. There are many different credit products available depending on the financing need:

Mortgage	Used to purchase a primary or secondary residence or investment property; can be fixed or floating rate with amortization or interest-only payments
Home equity LOC	A way to access equity in a home; usually floating rate with the ability to make interest-only payments
Unsecured loan	A way to borrow without collateral to meet short-term liquidity needs
Securities-based financing	Used to borrow against eligible securities in eligible accounts to maintain an asset allocation and avoid the cost associated with selling assets
Customized loans	Used for the purchase of nontraditional assets, such as commercial property, aircraft, or fine art

Risks to consider when using credit:

- *Collateral can depreciate to a value that is less than the amount borrowed.*
- *Rising interest rates can increase loan payments.*
- *Life events (job loss, retirement, etc.) may reduce cash flow and affect a borrower's ability to make payments.*



An example of using credit to gain liquidity

To help understand how credit can work as part of an investment strategy, consider this hypothetical example:

John is a small-business owner with $1 million in investment assets (including stocks, bonds, and real estate). John has cash flow from his investments and business, but a business need arose that required $100,000, and he did not have enough cash on hand to cover it. For help, he turned to his financial professional.

Reviewing the situation: His financial professional completed a full review of John's assets, liabilities, and liquidity needs. She noted that John was interested in a tax-efficient strategy that didn't alter his investment portfolio. He was comfortable with borrowing and had cash flow to cover monthly payments.

Considering all possible funding alternatives: His financial professional discussed the various possibilities to address John's immediate funding needs. This included liquidating assets, borrowing against his real estate holdings, and employing securities-based financing.

Making an informed choice: After hearing all of the choices available, John decided securities-based financing would be the best alternative for him. This allowed him to retain and leverage his assets without disrupting his existing investment strategy while also avoiding potential tax consequences associated with liquidation.

Monitoring the approach: Securities-based financing may have been the best choice for John at the time; however, investors should regularly reassess their financial profile, the market environment, and their stage of life. As these components change, the possibility for liquidity needs may change as well.

The solution discussed may not be suitable for your personal situation, even if it is similar to the example presented. Investors should make their own decisions based on their specific investment objectives and financial circumstances. It should not be assumed that the recommendations made in this situation achieved any of the goals mentioned. This example is hypothetical and does not represent any specific investment or strategy.

Three steps to incorporating credit into an investment strategy

Define goals and priorities …	Develop a strategy …	Monitor life-cycle changes …
• Work with a financial professional to determine short- and long-term financial goals. • Assess assets, liabilities, and liquidity needs on a regular basis.	• Work with a financial professional to set an investment strategy based on personal or business investment objectives and risk tolerance. • Consider the strategic and tactical use of assets and liabilities to help manage liquidity needs and build wealth.	• As life milestones approach, reassess liquidity positions and consider the potential benefits and risks of borrowing versus selling assets.

Risk considerations

Securities-based lending has special risks and is not suitable for everyone. If the market value of a client's pledged securities declines below required levels, the client may be required to pay down his or her line of credit or pledge additional eligible securities in order to maintain it, or the lender may require the sale of some or all of the client's pledged securities. Wells Fargo Advisors will attempt to notify clients of maintenance calls but is not required to do so. Clients are not entitled to choose which securities in their accounts are sold. The sale of their pledged securities may cause clients to suffer adverse tax consequences. Clients should discuss the tax implications of pledging securities as collateral with their tax advisors. Wells Fargo Advisors and its affiliates are not tax or legal advisors. An increase in interest rates will affect the overall cost of borrowing. All securities and accounts are subject to eligibility requirements. Clients should read all lines of credit documents carefully. The proceeds from securities-based lines of credit may not be used to purchase additional securities or pay down margin or for insurance products offered by Wells Fargo and any of its affiliates. Securities held in a retirement account cannot be used as collateral to obtain a loan. Securities purchased in the pledge account must meet collateral eligibility requirements.