

**Investments**

Offense versus defense in portfolio management  
Wild ride for stocks

**Taxes**

Year-end financial planning checklist

**Retirement planning**

Second look at plan distributions

# Investment & Trust Newsletter

November 2009

## Offense versus defense in portfolio management

### 2

**With trust investing, the standard is “prudence.”**

Investors are looking for three things from their portfolios: income, asset growth and safety of principal. These are not mutually exclusive goals, but neither are they fully

compatible. When the focus is on controlling risk, one is playing defense. Low-volatility investments will play an important role. By definition, these will offer little in the way of growth potential, and in a market environment dominated by low interest rates, they are also not likely to produce much income. To boost income or growth will necessarily mean accepting more risk, including the risk of loss. For a partial look at what that has meant so far in this century, see “Wild ride for stocks” on Page 2.

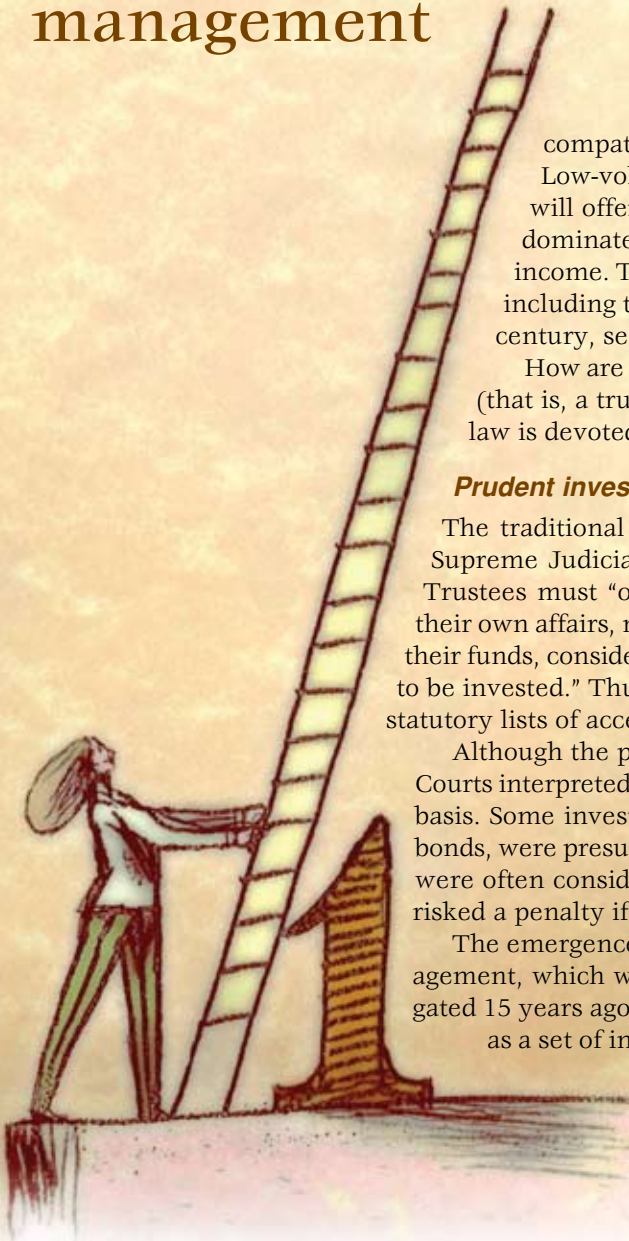
How are these trade-offs managed when the investment manager is a fiduciary (that is, a trust company or the trust division of a bank)? Interestingly, a body of law is devoted to answering this question.

#### **Prudent investing**

The traditional answer for how to manage trust assets was given in 1830 by the Supreme Judicial Court of Massachusetts in the case of *Harvard College v. Amory*. Trustees must “observe how men of prudence, discretion and intelligence manage their own affairs, not in regard to speculation, but in regard to permanent disposition of their funds, considering the probable income, as well as the probable safety of the capital to be invested.” Thus the “prudent man rule” was born, replacing the earlier practice of statutory lists of acceptable trust investments.

Although the prudent man rule sounds flexible, in practice it turned out not to be. Courts interpreted the rule to apply to each and every trust investment, on an individual basis. Some investment classes, such as government bonds or highly rated corporate bonds, were presumptively prudent, while others, such as stocks that paid no dividends, were often considered off-limits. Even if the trust performed well overall, the trustee risked a penalty if any higher-risk investment failed to pay off.

The emergence of modern portfolio theory has led to a new approach to trust management, which was embodied in the Uniform Prudent Investor Act (UPIA), promulgated 15 years ago. Under the new approach, the portfolio is evaluated as a whole, not as a set of individual parts. What's more, a trustee's duty to diversify trust assets,



which is consistent with modern portfolio theory, was included.

Under the old "prudent man" standard, personal trusts were very conservatively managed. The new laws were expected to enable a somewhat more aggressive approach, yet one still constrained by the risk tolerances of the beneficiaries, which might value safety and income over asset growth. Experience has borne this out.

### Steps in our investment process

Whether we are accepting management of a trust or undertaking an investment management account for a new client, the process will look something like this:

- Review the governing instrument to determine our investment authority.
- Gather client data, including risk tolerance, time horizons, liquidity needs, tax profiles, and unique circumstances.
- Determine the purposes, terms, distribution requirements and other circumstances of the trust.
- Articulate the trust's risk parameters.
- Establish investment objectives and an investment policy.

- Determine the diversification requirements for the trust.

- Establish an ongoing monitoring and reviewing methodology.

### A short list of our services for investors

Our services are, in essence, powerful financial planning tools built upon important investment management components. One of the great strengths of trust planning is the ability to tailor the plan to respond flexibly to current and future financial needs.

*Portfolio supervision.* Serious investing is a full-time job. Our investment advisory and investment management services put experienced investment professionals on your side. The officer assigned to your account will work with you to establish an investment strategy suited to your personal goals and circumstances. Asset allocation planning will be employed to optimize your portfolio.

*Lifetime financial management.* The next step in comprehensive financial protection employs a revocable living trust. As trustee, we can move beyond the investment sphere, arranging to pay household bills and taxes on your behalf. A revocable

trust provides financial protection in the event of incapacity, and it has important estate planning advantages as well.

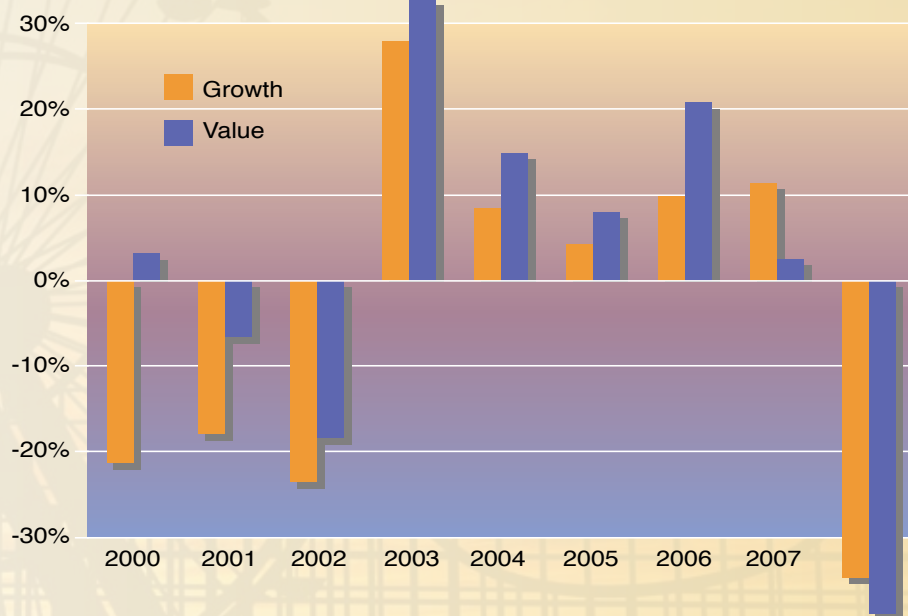
*IRA rollovers.* Anyone who will receive a lump sum distribution from an employer's retirement plan would be well advised to take a careful look at an IRA rollover for the funds. A rollover preserves valuable tax privileges and can enhance your retirement capital. Taxable withdrawals may begin without penalty at age 59½, and a program of minimum withdrawals must begin at age 70½. With their tax-deferred nature, IRA rollovers present somewhat unusual investment issues, which should be resolved in the context of a full review of financial resources.

### Can we tell you more?

Are you satisfied with your current portfolio management? Would a second opinion about your strategies be helpful? Our portfolio managers are at your service. This month, why not arrange for an appointment to learn more about how our services for investors may benefit you and your family? □

## Wild ride for stocks

Whether you invest for growth or value in the equity portion of your portfolio, this has been a bumpy century so far. This graph contrasts the annual returns of growth and value stocks since 2000, according to the *Ibbotson S&P 2009 Classic Yearbook*. Overall, the value investors fared slightly better, but not by much.



Source: M.A.Co.; Data: *Ibbotson S&P 2009 Classic Yearbook*

# Year-end financial planning checklist

## **Attention to the details is important for success.**

Tax planning never seems to get any easier. The largest cloud is the prospect of higher taxes. The usual rule of thumb is to defer income and accelerate deductions when possible. However, higher tax rates are already on the books for 2011, and there is a chance that they could be accelerated. When rates are going up, it makes more sense to accelerate income and defer deductions for maximum tax efficiency.

Volatile financial markets make portfolio analysis especially complex, as stock prices have been on a heart-stopping roller-coaster ride. Keep these points in mind during your year-end review:

- **Should you take additional capital gains or losses?**

As you review your investment activity for 2009, note any additional sales that seem appropriate from an investment standpoint — then check with your tax adviser. You'll want to make your remaining investment moves with maximum tax efficiency, offsetting gains and losses as appropriate.

- **Have you drifted from your asset allocation plan?**

For example, if your portfolio has become underweighted in equities, you may want to consider rebalancing to restore your exposure to upside potential.

- **Are your investment costs under control?** Investing can become an expensive proposition if you don't keep a close eye on the costs involved, and the full extent of these costs can be difficult to discern. Need help in evaluating your investment expenses? We'll be glad to assist you and, where appropriate, suggest economical alternatives.

- **Should you be planning to convert to a Roth IRA?**

The \$100,000 income cap on conversions of traditional IRAs to the potentially tax-free Roth IRA approach comes off on January 1, 2010. There is a big tax cost for the conversion, balanced by some important long-term benefits. With asset values well off their highs, 2010 may prove an important window of opportunity for conversions.

- **Year-end gifts: family.** One of the easiest tools to use for cutting estate taxes is the annual \$13,000 gift, which is excluded from the gift tax. You may make gifts of up to \$13,000 to as many people as you like, and married couples may make gifts of \$26,000. To avoid tax ambiguities, gift checks should be deposited before year-end.



- **Year-end gifts: charity.** Consider donating appreciated securities instead of an equivalent amount of cash. If you have owned the securities for more than a year, your donation of, for example, \$10,000 worth of stock will earn you the same income tax deduction as a cash donation. In addition, you will eliminate the capital gains tax that would have been triggered by a sale of the stock.

- **Have your family circumstances changed?** If you have changed your marital status or if you have become a parent or grandparent, it's time for a review of your will and your estate plans. Keeping your will current is an important step, one many people neglect. You would be surprised at how many wills we see that are more than ten years old, some naming as beneficiaries people who already have died.

- **Are you an estate tax target?** This year, the exemption from the federal estate tax is \$3.5 million, but many states impose death taxes (estate or inheritance taxes, or both) on smaller estates. Next year, under current law, the federal estate tax is suspended, followed by a \$1 million exemption and sharply higher tax rates in 2011. If your assets put you anywhere near this tax neighborhood, you'll want to maintain close contact with your estate planner for the next several years.



The busier you are, the more important it is that you take time for regular reviews of your investment and financial planning. We'd be pleased to work with your tax and legal advisors to help you stay on top of things. Call on us! □

## Second look at plan distributions

In general, those who are 70½ and older must take “required minimum distributions” (RMDs) from their qualified retirement plan accounts, such as IRAs and 401(k)s. In 2008, some taxpayers were whipsawed when the value of their accounts fell between the time that they were valued for calculating their RMDs and the time that the distribution was made. Forced distributions in a declining market have the effect of locking in market losses. Affected taxpayers asked Congress for some relief.

There was no relief for the 2008 tax year, but Congress did suspend the RMD rules for 2009, to give retirees a chance to rebuild their portfolios. However, some retirees may have received RMDs anyway, perhaps because they didn’t notify the plan in time to opt out for the year. Or the retiree may have gone ahead with taking an RMD but now may wish to reverse course.

RMDs may be rolled back into a qualified plan or an IRA within 60 days after the distribution. The IRS extended the grace period for this year to the later of 60 days or November 30, 2009. That means someone who took an RMD last March, for example, can roll the distribution back into an IRA by November 30 and avoid current income taxes on it.

**Situation 1.** Frances received a \$5,000 RMD in July 2009 from her 401(k). She may roll the money back into the 401(k), or into a new IRA, until November 30.

**Situation 2.** Now say that Frances received the RMD check on October 15. She has until December 15 to make the rollover.

Some retirees take their RMDs as a series of payments. In this situation, the type of account will affect the rollover availability.

**Situation 3.** David received \$2,000 per month during the first six months of 2009 from his 401(k). All the payments may be rolled back into the plan.

**Situation 4.** Now say that David took those payments instead from his IRA. Only one rollover from one IRA to another is permitted per year, so only \$2,000 is eligible to be returned.

There is an alternative for David to consider. If he is otherwise qualified to roll his IRA distributions into a Roth IRA (that is, adjusted gross income in 2009 will be less than \$100,000), David can roll all the RMDs he received into Roth IRAs. Or he can roll one RMD back into a traditional IRA and roll the rest into a Roth IRA. There is no one-per-year limit for rollovers to Roth IRAs. This approach creates the possibility of tax-free account growth for David if he otherwise had enough retirement income. □



## Does your parent or spouse have signs of Alzheimer’s disease?

The financial impact of dementia can be almost as devastating as the disease itself. Thoughtful trust planning can be part of the solution. With a living trust, we provide continued financial management in the event of incapacity.

When you have uncommon financial planning concerns, please turn to us for answers.

Call our trust professionals for an appointment.

**Randy J. Dickinson**  
Vice President  
& Trust Officer

**Michelle Mease**  
Assistant Vice President  
& Trust Officer

**Miles Coffland, CPA**  
Trust Officer



Phone: 989-772-9471 Fax: 989-773-3735