IN THIS ISSUE

Investing
The volatility economy
Market volatility in retirement

Estate planning
Alarm bells for estate planners?

Philanthropy
Who gives?
Give it back

Trust UPDATE

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Volatility. The new normal.

Steps to steady your portfolio

Today's economy seems packed with unprecedented problems. Home prices remain depressed in much of the country, and home sales are sluggish. To the immediate problem of loss of wealth to the homeowners, one must add the fact that some homeowners may be anchored by their homes, unable to relocate for better employment because they can't sell the old house. The puzzle of European sovereign debt lurches from one "solution" to another, yet somehow never gets resolved. Oil prices are ratcheting up again, which is not at all unprecedented. Unfortunately, the precedents suggest that increasing oil prices go hand in hand with stagnant or declining economic growth.

Against this gloom, there are some bright spots. Corporate profits have surged, and stock prices have responded favorably. Many luxury retailers have done especially well, as have some computer makers and social media companies.

Stocks and bonds have been on a roller-coaster ride during this volatile economy. After suffering a 37% collapse in 2008, the large company stocks represented by the S&P 500 grew by 26% in 2009 and 15% in 2010 (including dividends). Bonds delivered almost a mirror image, gaining nearly 26% in 2008, then losing nearly 15% the following year, as stocks returned to favor. Here is more detail on the performance of the indices.

Recent total returns, stocks and bonds

Year	Large-cap stocks	Long-term government bonds
2007	5.49%	9.88%
2008	-37.00%	25.87%
2009	26.46%	-14.90%
2010	15.06%	10.14%
2011	2.11%	28.23%

Source: M.A. Co.; 2012 Ibbotson SBBI Market Report.

Balancing act

To avoid the overweighting of one asset class or another, one needs to employ an *asset allocation strategy* for smoothing portfolio performance. Much of the riskiness of an investment portfolio can be mitigated in this way. Here are the returns for various mixes of stocks and bonds in the last five years.

Continued on next page

A question of balance

Year	70% stocks, 30% bonds	50% stocks, 50% bonds	30% stocks, 70% bonds
2007	7.30%	7.95%	8.79%
2008	-21.55%	-9.72%	3.43%
2009	12.97%	4.49%	-3.58%
2010	14.52%	13.70%	12.53%
2011	10.07%	15.34%	20.56%

Source: M.A. Co.; 2012 Ibbotson SBBI Market Report.

The exceptional performance of long-term government bonds in recent years is attributable to the sustained period of low interest rates. A period of rising interest rates could reverse this result.

An asset allocation plan will employ many more than two asset classes. The historical performance of the asset classes is the starting point; the degree to which the classes move in sync or not is determined mathematically. With these coefficients in hand, the portfolio may be optimized. That means expected performance may be maximized for a given level of acceptable investment risk. Alternatively, risk may be minimized for a target level of return.

We can help

Unbiased investment management is an integral part of our service as trustee, but you don't need to create a trust to be able to call upon our professional expertise. We manage investment portfolios for a fee for individuals and families in a wide variety of situations.

This month, why not schedule a meeting with us to learn more? ☐

Market volatility in retirement

As difficult as jumpy markets are for savers, they can be even more ominous for retirees. Imagine a soon-to-be retiree who has a $500,000 portfolio from which he or she will need to draw $25,0000 annually. That's just 5%. How long will the money last? The answer turns upon whether the retirement begins in a bull or a bear market.

In a bull market, as the table below of hypothetical returns shows, the retirement money will continue to grow in the early years, despite the withdrawals. The fund is better cushioned for setbacks that occur later.

Retire in a bull market

Year	Return	Withdrawal	Value
			$500,000
1	25%	$25,000	$600,000
2	18%	$25,000	$683,000
3	8%	$25,000	$712,640
4	12%	$25,000	$773,157
5	10%	$25,000	$825,472
6	3%	$25,000	$825,237
7	8%	$25,000	$866,256
8	-2%	$25,000	$823,930
9	-4%	$25,000	$765,973
10	-28%	$25,000	$526,501

Source: M.A. Co.

Although that loss of 28% in the 10th year was severe, it did not bring the fund below where it was when retirement started.

But if we reverse the sequence of returns, the result is very different, as seen in this table.

Retire in a bear market

Year	Return	Withdrawal	Value
			$500,000
1	-28%	$25,000	$335,000
2	-4%	$25,000	$296,600
3	-2%	$25,000	$265,668
4	8%	$25,000	$261,921
5	3%	$25,000	$244,779
6	10%	$25,000	$244,257
7	12%	$25,000	$248,568
8	8%	$25,000	$243,453
9	18%	$25,000	$262,275
10	25%	$25,000	$302,844

Source: M.A. Co.

The strong returns have a smaller base upon which to build. Accordingly, when markets are doing poorly, one may need to delay retirement, reduce spending, or work with an investment advisor who can smooth the bumps in portfolio returns.

This simplified example ignores the effects of taxes and inflation on spendable income. ☐

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Alarm bells for estate planners?

For estate planners and their clients, these are difficult and uncertain times. This year, the amount exempt from federal estate and gift taxes is $5.12 million, and the tax rate is 35%. Next year, under current law, the exemption collapses to $1 million, and the top tax rate soars to 55% (60% for some estates).

Will those draconian tax increases really happen? No one knows. In 2010, the last time that the country was on the brink of returning to the estate tax regime of the last century, Congress came up with the current temporary extension of targeting the transfer tax to the top 1%. However, deficits are more severe now, and the "tax the rich" rhetoric has gotten louder. The chance of compromise in an election year appears remote, so everything may turn upon the outcome of the November elections.

What does the President want?

President Obama's proposed 2013 budget offers insight into the approaches that he favors. In one sense, the budget offers a compromise compared to the current law. The estate tax exemption would fall to $3.5 million, not $1 million, while the top estate tax rate would reach "only" 45%. The gift tax exemption would shrink to $1 million. These are the tax rules that applied in 2009.

In another sense, however, the President's budget could boost tax receipts by targeting a wide range of estate planning strategies for new taxes, and so it might not be much of a compromise at all. In the crosshairs:

Grantor retained annuity trusts (GRATs). The grantor (the trust creator) places income-producing assets in a trust, reserving an annuity for a given number of years. When the annuity payments end, the trust assets pass to the grantor's heirs. That transfer is a potentially taxable gift at the time the trust is funded, but the amount of the gift is adjusted actuarially to account for the delay and the value of the intervening annuity. Current law permits the grantor to "zero out" the value of the gift, avoiding all gift tax. The President's budget would change that rule and also require that GRATs continue for at least 10 years. Only newly created GRATs would be affected.

Grantor trusts. Although the name is similar, the function of this trust is quite different. These trusts take advantage of the fact that estate, gift, and income taxes are not perfectly parallel. A transfer to a trust that is considered complete for gift tax purposes might still be treated as belonging to the grantor for the income tax. When the grantor pays the tax on the trust's income, that is the economic equivalent of making a gift to the trust's beneficiaries. However, the IRS has ruled that the gift tax is not triggered by paying an income tax in this circumstance. The budget calls for treating beneficiary distributions from grantor trusts to be subject to gift tax, and for the trust itself to be subject to the estate tax at the grantor's death.

Dynasty trusts. A perpetual private trust is now permitted in some states, with the abolition of the rule against perpetuities. Some families have used these "dynasty trusts" to avoid repeated imposition of the estate and gift tax on the family fortune at every generation. The President's proposal would assert a new transfer tax on such trusts after 90 years, ending the perpetual exemption.

See your advisors to learn more

Estate plans always need to be revisited when there are changes in family circumstances or in the family's fortunes. To these situations, we now need to add the shifting tax laws. Often, the effects of tax law changes upon an estate plan are unpredictable, especially if the documents rely upon formulas to try to keep taxes low.

If you might be affected by the potential tax law changes, or if you've been considering any of the trust plans mentioned here, see your tax and legal advisors soon. Don't put off the evaluation of planning opportunities that could enhance your family's financial security significantly. ☐

Who gives?

The Chronicle of Philanthropy has compiled a list of the top 50 charitable givers for 2011. Only new gifts are included, so Warren Buffett, Bill and Melinda Gates, and Ted Turner didn't make the cut. Their very substantial 2011 donations were fulfillments of earlier pledges.

As a group, the top 50 gave $10.4 billion last year. Upon closer inspection, that isn't quite as significant as it may appear at first blush. Some $6 billion of the total was a single bequest, from Margaret Cargill, heir to the Cargill fortune. The money passed to her charitable foundation and to the Ann Ray Charitable Trust. Another point to consider: 10 years ago, the top 50 givers donated $12.5 billion to charity.

Ten years ago, it took $15 million in donations to be on the top 50 list; last year, $26 million did the trick. Other tidbits highlighted in the *Chronicle* study:

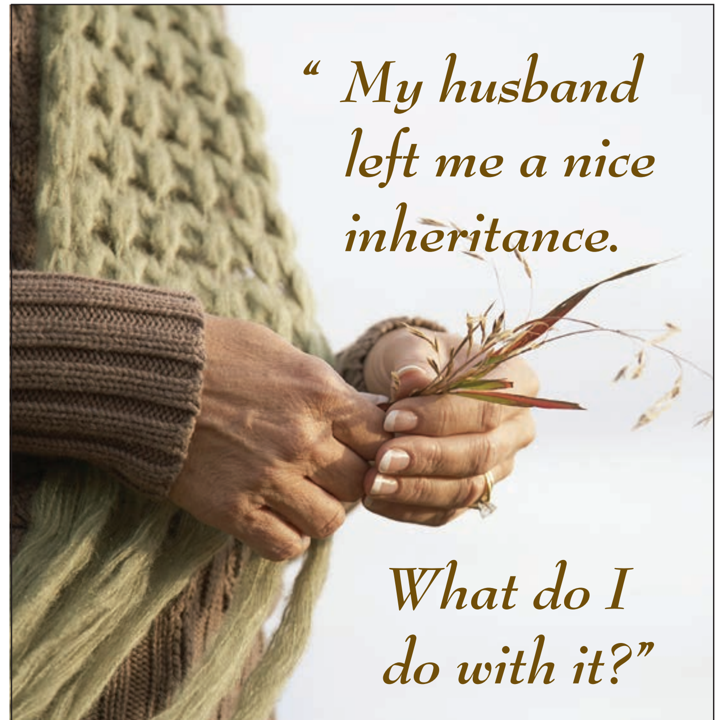
- Only 5 of the top 50 givers inherited their wealth.
- More than 20% of these top givers made their money in finance.
- 32 of the givers were on the list for the first time.
- 9 have been on the list at least 5 times.
- 7 top donors were under 50, and 3 were over 90.
- 10 of the top 50 charitable gifts were bequests.
- The most popular object of major philanthropy was colleges, with 19 major gifts.
- 14 of the top 50 donors were in California, more than in any other state.

Only 21 of the 400 richest people in America, as reported by *Forbes* magazine, made major charitable gifts in 2011. However, not everyone needs to be in the spotlight with his or her charitable giving. The *Chronicle* reported that in 2011 there were 76 anonymous gifts of $1 million or more, totaling $546 million.

Give it back

Garth Brooks gave a hospital in Yukon, Oklahoma, $500,000. He believed that he had an oral agreement that the hospital would create a women's center named for his mother. The hospital evidently thought that the gift was unrestricted. They did not create the center, stating later that $500,000 was too small a gift for such a project. Brooks sued for the return of his gift. In February a jury ordered the repayment of the gift, with an additional $500,000 in punitive damages for acting with malice in ignoring the donor's intent.

Why the extra damages? Perhaps because the hospital president wrote the following e-mail to his colleagues in 2009: "We may not deny Garth access to the money. However, we can sure as hell make him work to get it back." ☐



In difficult economic times, many people face choices that they never expected to have to make. Making those choices alone, when one has been accustomed to partnership, can be especially daunting.

It has been our privilege to be of service to many affluent families over the years. May we be of service to yours as well?

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