Wealth Management

INVESTMENTS, ADVICE & TRUST SERVICES

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Risk and Your Investments

Every investment is subject to risk, but there are different types of risk. Some are specific to an investment, and other types of risk are broader. It's important to take the different kinds of risk into consideration when crafting a portfolio and monitoring its performance.

Company-specific Issues

Inferior leadership, substandard business strategies, negative publicity, or a surge in competition could cause a company's stock value to drop. Although careful research and close monitoring of a company can alert investors to potentially adverse situations, a company's troubles can sometimes develop rapidly. Investing the stock portion of your portfolio in a number of companies helps protect against large declines in portfolio value due to company-specific risks.

Possibility of Default

Corporate bond investors run the risk that the issuing company may not be able to make the required payments on its debt. As an investor, you might lose some or all of the money you have invested. Generally, lower rated "junk" bonds offer higher interest rates than investment-grade bonds but also have a higher risk of default. Verifying bond credit ratings with a bond-rating agency, such as Standard & Poor's or Moody's, and investing in higher rated bonds can help reduce exposure to default risk.

Impact of Inflation

Another concern for long-term investors is that the money they've invested may buy less as inflation increases the prices of the goods and services and reduces the purchasing power of money. Even conservative investors may want to invest a portion of their portfolios in asset classes that have the potential for earning inflation-beating returns, such as stocks.

Movements in Interest Rates

Interest rate changes can directly affect the

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Financial Markets Update

Jason Ritzenthaler, CFA, CTFA

Equity markets rallied significantly from the lows experienced in January and February. Incoming economic data has shown a continuation of the slow growth economy we have been in rather than an oncoming recession in the short term. In the last newsletter, we highlighted the risks of having a short-term focus. The recent market rally was a good reminder of not becoming too pessimistic during market declines.

As of May 31st, the S&P 500® was up 9.12%, US Midcap up 12.38%, and US Smallcap up 11.28% over the last three months. International equity markets also did well with MSCI EAFE Developed markets up 8.91% and MSCI Emerging markets up 9.64%.

June has seen an uptick in volatility with the UK referendum vote going to the leave the EU camp. We expect market volatility to continue over the next few months, but we remain optimistic on returns through the end of the year. Our investment team expects the S&P 500® to finish the year up 5%-7% with US Midcap, US Smallcap, and Emerging markets doing a bit better.

Insuring Two Individuals with Survivorship Life Insurance

A survivorship or second-to-die life insurance policy can be a cost-effective way to help preserve wealth for future generations. Unlike most life insurance policies, it insures two lives (usually a husband and wife) using one policy, with benefits paid after the second insured individual passes away.

Buying a survivorship life insurance policy may be less expensive than purchasing two separate policies since the premium is based on the joint life expectancy of both insured individuals (and other actuarial factors). If one spouse is difficult to insure because of poor health, qualifying may be easier since benefits aren't paid until both individuals die.

Under federal tax law, you can generally leave an unlimited amount of assets to your spouse with no federal estate tax due. Any assets owned by your spouse upon death become part of his or her estate. Creating an irrevocable trust to hold the survivorship life insurance policy and naming the trust as the policy beneficiary can remove the death benefit from the surviving spouse's estate. To pay the premiums, each spouse may make annual gifts to the trust. The gifts would not be subject to gift taxes to the extent that they can be protected by the gift-tax annual exclusion. (Various requirements apply.)

Planning Possibilities

Survivorship life insurance benefits may serve a variety of purposes:

- **Paying federal and/or state estate taxes and estate settlement costs due upon the second death, preserving more of the estate for beneficiaries**
- **Avoiding the need to sell illiquid assets, such as a family business, in order to pay estate expenses**
- **Replacing wealth spent on expenses such as health care during either insured individual's lifetime**
- **Equalizing inheritances among children**
- **Providing funds for charitable contributions**

Giving to Charity with a CRT

Are you considering making a significant charitable donation? Using a charitable remainder trust (CRT) as the vehicle for your gift may provide you with both tax benefits and an income stream during your lifetime.

Selling appreciated assets (e.g., stocks) could result in a significant capital gains tax liability. By transferring the assets to a CRT, you avoid the capital gains liability and benefit from a tax deduction for your charitable contribution equal to the present value of the charity's interest in the trust.* This also removes the assets from your estate. You receive income from the trust during your lifetime (and, if you choose, the lifetime of a beneficiary) or for a specified number of years (up to 20).

Because a qualified CRT is exempt from income tax, the CRT trustee can generally sell the assets in the trust without recognizing any gain. Upon your death or at the end of a specified period, the remaining assets will belong to your designated charity, not your loved ones. One way to provide for your family is to fund a wealth replacement trust with life insurance. Your beneficiaries will then receive the proceeds upon your death.

* Deductions for charitable contributions are subject to certain limits.

Adjusting Your Portfolio by Rebalancing

Your mix of stocks, bonds, and cash alternative investments should fit your investment goals and risk tolerance. But different asset classes produce different returns over time, and that can change your asset allocation. A review of your investment portfolio at least annually can let you know if you should consider rebalancing.

Monitoring Your Asset Allocation

With changes in the securities markets, the percentages you invested in each asset class may fluctuate. This can affect your investment portfolio's diversification profile and exposure to risk. Moreover, your goals and risk tolerance may change over time. Your investment time frame may be different than it was previously or you may not be earning the returns you need to reach your goals. Rebalancing can ensure that your asset mix reflects your current investment strategy.

Options for Rebalancing

There are different ways to rebalance a portfolio. One is by directing future account contributions (including earnings, such as dividends) to asset classes that are lagging until you reach your preferred allocation. Another method is to sell investments in asset classes that have been doing well and reinvest the proceeds in asset classes that are underperforming. Before rebalancing outside a tax-favored retirement account, it's important to be aware of the potential tax implications.

It can be difficult to sell investments that have increased in value. However, asset classes that are currently performing well could soon suffer a downturn, and asset classes that are currently falling behind may rebound in the future. Making rebalancing part of a regular routine will allow you to maintain an asset allocation that can help you achieve your financial goals.

Guidelines for Gift-tax Returns

If you make a gift to a child, grandchild, or other individual, you may have to file a federal gift-tax return. Generally, you will have to file a gift-tax return if your gift to any one person is over the gift-tax annual exclusion in effect for that year. For 2016, the exclusion is $14,000. Under current law, you will not owe any federal gift tax until the total value of gifts in a lifetime is over $5,450,000.

"Generally, you will have to file a gift-tax return if your gift to any one person is over the gift-tax annual exclusion in effect for that year."

You can double the annual tax-free amount per recipient by splitting a gift with your spouse. However, you will have to file a gift-tax return to inform the IRS that you have made a split gift.

Exceptions to the filing requirement include gifts to your spouse and qualified charities. Moreover, no gift-tax return is required when gifts are qualifying transfers for educational or medical expenses. (Such gifts may exceed the $14,000 annual exclusion limit.)

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values of bond investments. The prices of bonds decline when interest rates increase since older bonds are paying less than newly issued bonds. If you sell bonds before maturity, you could lose money. "Duration" measures a bond's price sensitivity to changes in interest rates. When interest rates rise, low duration bonds should experience less price variation than those with a high duration.

Investing Abroad

Changes in exchange rates between a foreign currency and the U.S. dollar can affect your international investments by reducing (or increasing) your investment returns. Foreign tax rules, differences in auditing and financial standards, potential liquidity concerns, and political uncertainty are additional risk factors that should be considered when investing abroad.

Managing Risk

Although investment risk cannot be eliminated, it can be managed. Since the asset classes respond in varying ways to market risk, including different asset classes in a portfolio reduces the risk of significant loss that could occur from concentrating a portfolio in a single asset class. Similarly, holding a well-diversified* mix of securities helps to manage an investor's exposure to risks that could affect a single company or a small economic sector.

The input and assistance of knowledgeable professionals can be invaluable in constructing a portfolio that fits both your risk tolerance and your personal investing goals. Please do not hesitate to contact us.

** Diversification does not ensure a profit or protect against loss in a declining market.*

This publication involves sophisticated tax and financial planning concepts. Before applying anything you read to your situation, you should consult with your professional advisor.

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