



# Private Wealth Management

## *Helping You Achieve Financial Success*

### Assessing Portfolio Performance: Choose Your Benchmarks Wisely



You can't help but hear about the frequent ups and downs of the Dow Jones Industrial Average or the S&P 500 index. The performance of both major indexes is widely reported and analyzed in detail by

financial news outlets around the nation.

Like the Dow, the S&P 500 tracks the stocks of large domestic companies. With 500 stocks compared to the Dow's 30, the S&P 500 comprises a much broader segment of the stock market and is considered to be representative of U.S. stocks in general. Both indexes are generally useful tools for tracking stock market trends, but some investors mistakenly think of them as benchmarks for how well their own portfolios should be doing.

However, it doesn't make much sense to compare a broadly diversified, multi-asset portfolio to just one of its own components. Expecting portfolio returns to meet or beat "the market" is usually unrealistic, unless you are willing to expose 100% of your life savings to the risk and volatility associated with stock investments.

#### **Asset allocation: It's personal**

Just about every financial market in the world is tracked by one or more indexes that investors can use to look at current and historical performance. In fact, there are hundreds of indexes based on a wide variety of asset classes (stocks/bonds), market segments (large/small cap), and styles (growth/value).

Investor portfolios are typically divided among asset classes that tend to perform differently under different market conditions. An appropriate mix of stocks, bonds, and other investments depends on the investor's age, risk tolerance, and financial goals.

Consequently, there may or may not be a single benchmark that matches your actual holdings and the composition of your individual portfolio. It could take a combination of several benchmarks to provide a meaningful performance picture.

#### **Keep the proper perspective**

Seasoned investors understand that short-term results may have little to do with the effectiveness of a long-term investment strategy. Even so, the desire to become a more disciplined investor is often tested by the arrival of quarterly or annual financial statements.

The main problem with making decisions based on last year's performance figures is that asset classes, market segments, or industries that do well during one period don't always continue to perform as well. When an investment experiences dramatic upside performance, it may mean that much of the opportunity for market gains has already passed. Conversely, moving out of an investment when it has a down year could mean you are no longer in a position to benefit when that segment starts to recover.

On the other hand, portfolios that are left unattended may drift and begin to take on too much risk or become too conservative. Rebalancing periodically could help bring your asset mix back in line with your preferred allocation.

There's really nothing you can do about global economic conditions or the level of returns delivered by the financial markets, but you can control the composition of your portfolio. Evaluating investment results through the correct lens may help you make appropriate adjustments and effectively plan for the future.

**Note:** *Keep in mind that the performance of an unmanaged index is not indicative of the performance of any specific security, and individuals cannot invest directly in an index. Asset allocation and diversification are methods used to help manage investment risk; they do not guarantee a profit or protect against investment loss. All investments are subject to market fluctuation, risk, and loss of principal. Shares, when sold, may be worth more or less than their original cost. Investments that seek a higher return tend to involve greater risk. Rebalancing may result in commission costs, as well as taxes if you sell investments for a profit.*

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Estate Planning Strategies in a Low-Interest-Rate Environment

Are There Gaps in Your Insurance Coverage?

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## Estate Planning Strategies in a Low-Interest-Rate Environment



*Low interest rates favor certain estate planning strategies over others, and the interest rates used by the IRS are at or near historic lows.*

*There may be costs and expenses associated with any of these strategies. Also, payments from these strategies are not guaranteed.*

The federal government requires the use of certain published interest rates to value various items used in estate planning, such as an income, annuity, or remainder interest in a trust. The government also specifies interest rates that a taxpayer may be deemed to use in connection with certain installment sales or intra-family loans. These rates are currently at or near historic lows, presenting several estate planning opportunities.

Low interest rates favor certain estate planning strategies over others. For example, low interest rates are generally beneficial for a grantor retained annuity trust (GRAT), a charitable lead annuity trust (CLAT), an installment sale, and a low-interest loan. On the other hand, low interest rates generally have a detrimental effect on a qualified personal residence trust (QPRT) and a charitable gift annuity. But interest rates have little or no effect on a charitable remainder unitrust (CRUT).

### **Grantor retained annuity trust (GRAT)**

In a GRAT, you transfer property to a trust, but retain a right to annuity payments for a term of years. After the trust term ends, the remaining trust property passes to your designated beneficiaries, such as family members. The value of the gift of the remainder interest is discounted for gift tax purposes to reflect that it will be received in the future. Also, if you survive the trust term, the trust property is not included in your gross estate for estate tax purposes. If the rate of appreciation is greater than the IRS interest rate, a higher value of trust assets escapes gift and estate taxation. Consequently, the lower the IRS interest rate, the more effective this technique can be.

### **Charitable lead annuity trust (CLAT)**

In a CLAT, you transfer property to a trust, giving a charity the right to annuity payments for a term of years. After the trust term ends, the remaining trust property passes to your designated beneficiaries, such as family members. This trust is similar to a GRAT, except that you get a gift tax charitable deduction. Also, if the CLAT is structured so that you are taxed on trust income, you receive an up-front income tax charitable deduction for the gift of the annuity interest. Like with a GRAT, the lower the IRS interest rate, the more effective this technique can be.

### **Installment sale**

If you enter into an installment sale with family members, you can generally defer the taxation of any gain on the property sold until the installment payments are received. However, if the family member resells the property within

two years of your installment sale, any deferred gain will generally be accelerated. The two-year limit does not apply to stocks that are sold on an established securities market.

You are generally required to charge an adequate interest rate (based on IRS published rates) in return for the opportunity to pay in installments, or interest will be deemed to be charged for income tax and gift tax purposes. However, with the current low interest rates, your family members can pay for the property in installments while paying only a minimal interest cost for the benefit of doing so.

### **Low-interest loan**

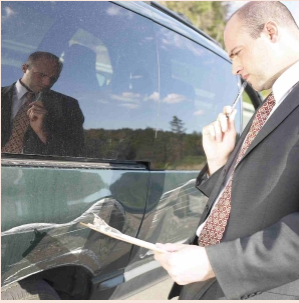
A low-interest loan to family members might also be a useful strategy. You are generally required to charge an adequate interest rate on the loan for the use of the money, or interest will be deemed to be charged for income tax and gift tax purposes. However, with the current low interest rates, you can provide loans at a very low rate, and family members can effectively keep any earnings in excess of the interest they are required to pay you.

### **Effect of low rates on other strategies**

- **Charitable remainder unitrust:** You transfer property to a trust, retaining a stream of payments for life or a number of years, after which the remainder passes to charity. You receive a current charitable deduction for the gift of the remainder interest. Interest rates have no effect if payments are made annually at the beginning of each year, and low interest rates have only a minimal detrimental effect if payments are made in any other way.
- **Qualified personal residence trust:** You transfer your personal residence to a trust, retaining the right to live in the home for a period of years, after which the residence passes to your designated beneficiaries, such as family members. The value of the gift of the remainder interest is discounted for gift tax purposes to reflect that it will be received in the future. The lower the IRS interest rate, the less effective this technique can be.
- **Charitable gift annuity:** You transfer property to a charity in return for the charity's promise to make annuity payments for your life (or for the lifetimes of you and your spouse). You receive a current charitable deduction for the gift of the remainder interest. The lower the interest rate, the lower the amount of your charitable deduction. Also, charities have generally been forced to reduce payout rates offered because of economic uncertainties and the low-interest-rate environment.



## Are There Gaps in Your Insurance Coverage?



*If you own a condo, your association's property insurance may leave gaps in coverage. For example, most association insurance doesn't cover your furniture, wall coverings, electronics, interior walls, and structural improvements made to the interior of your unit. Review your condo documents, particularly the association's master deed, its by-laws, rules and regulations, which may describe those parts of your unit the association insurance covers, and which parts you may need to insure.*



Buying insurance is about sharing or shifting risk. For example, health insurance will cover some of the cost of medical care. Homeowners insurance will assume some of the risk of loss in the event your home is damaged or destroyed. But oftentimes we think we're covered for specific losses when, in fact, we're not. Here are some common coverage gaps to consider when reviewing your own insurance coverage.

### Life insurance

In general, you want to have enough life insurance coverage (when coupled with savings and income) to allow your family to continue living the lifestyle to which they're accustomed. But changing circumstances may leave a gap in your life insurance coverage.

For example, if you have life insurance through your employer, changing jobs could affect your insurance coverage. You may not have the same amount of insurance, or the policy provisions may differ. Whereas your prior employer may have provided permanent life insurance, now you may have term insurance that will expire on a predetermined date. Review your income, savings, and expenses annually and compare them to your insurance coverage, and be mindful that changing circumstances may require a change in the amount of insurance coverage.

### Homeowners insurance

It's not always clear from reading your homeowners policy which perils are covered and how much damage will be paid for. It's important to know what your homeowners policy covers and, more important, what it doesn't cover.

You might think your insurer would pay the full cost to replace your home if it were destroyed by a covered occurrence. But many policies place a cap on replacement cost up to the face amount stated on the policy. You may want to check with a building contractor to get an idea of the replacement cost for your home, then compare it to your policy to be sure you have enough coverage.

Even if your policy states that "all perils" are covered, most policies carve out many exceptions or exclusions to this general provision. For example, damage caused by floods, earthquakes, and hurricanes may be covered only by special addendums to your policy, or in some cases by separate insurance

policies altogether. Also, your insurer may not cover the extra cost of rebuilding attributable to more stringent building codes, or your policy may limit how much and how long it will pay for temporary housing while repairs are made.

To avoid these gaps in coverage, review your policy annually with your insurer. Also, pay attention to notices you may receive. What may look like boilerplate language could actually be significant changes to your coverage. Don't rely on your interpretations--seek an explanation from your insurer or agent.

### Auto insurance

Which drivers and what vehicles are covered by your auto insurance? Most policies provide coverage for you and family members residing with you, but it's not always clear-cut. For instance, a child who is living in a college dorm is probably covered, but a child who lives in an off-campus apartment might be excluded from coverage. If you and your spouse divorce, which policy insures your children, particularly if they are living with each parent at different times of the year? Notify your insurer about any change in living arrangements to avoid a gap in coverage.

Other gaps include no coverage for damaged batteries, tires, and shocks. And you might not be covered for stolen or damaged cell phones or other electronic devices. Your policy may also limit the amount paid for a rental while your vehicle is being repaired.

In fact, insurance coverage for rental cars may also pose a problem. For instance, your own collision coverage may apply to the rental car you're driving, but it may not pay for all the damage alleged by a rental company, such as loss of use charges. If you're leasing a car long term, your policy may cover the replacement cost only if the car is a total loss or is stolen. But that amount may not be enough to pay for the outstanding balance of your lease. Gap insurance can cover any difference between what your insurer pays and the balance of your lease.

Policy terms and conditions aren't always easily understood, and you may not be sure what's covered until it's time to file a claim. So review your insurance policy to be sure you've filled all the gaps in your coverage.



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## I'm thinking about storing financial documents in the cloud. What should I know?

Cloud storage—using Internet-based service providers to store digital assets such as books, music, videos, photos, and even important documents including financial statements and contracts—has become increasingly popular in recent years. But is it right for you?

Opinions vary on whether to store your most sensitive information in the cloud. While some experts say you should physically store items you're not willing to lose or expose publicly, others contend that high-security cloud options are available.

If you're thinking about cloud storage for your financial documents, consider the following:

- Evaluate the provider's reputation. Is the service well known, well tested, and well reviewed by information security experts?
- Consider the provider's own security and redundancy procedures. Look for such features as two-factor authentication and complex password requirements. Does it have copies of your data on servers at multiple geographic locations, so that a

disaster in one area won't result in an irretrievable loss of data?

- Review the provider's service agreement and terms and conditions. Make sure you understand how your data will be protected and what recourse you have in the event of a breach or loss. Also understand what happens when you delete a file—will it be completely removed from all servers? In the event a government subpoena is issued, must the service provider hand over the data?
- Consider encryption processes, which prevent access to your data without your personal password (including access by people who work for the service provider). Will you be using a browser or app that provides for data encryption during transfer? And once your data is stored on the cloud servers, will it continue to be encrypted?
- Make sure you have a complex system for creating passwords and never share your passwords with anyone.



## What's the best way to back up my digital information?

In writing or speaking, redundancy is typically not recommended unless you're really trying to drive a point home. When it comes to your digital life, however, redundancy is not only recommended, it's critical.

Redundancy is the term used to refer to data backups. If you have digital assets that you don't want to risk losing forever—including photos, videos, original recordings, financial documents, and other materials—you'll want to be sure to back them up regularly. And it's not just materials on your personal computer, but your mobile devices as well. Depending on how much you use your devices, you may want to back them up as frequently as every few days.

A good rule to follow is the 3-2-1 rule. This rule helps reduce the risk that any one event—such as a fire, theft, or hack—will destroy or compromise both your primary data and all your backups.

1. Have at least three copies of your data. This means a minimum of the original plus two backups. In the world of computer redundancy, more is definitely better.

2. Use at least two different formats. For example, you might have one copy on an external hard drive and another on a flash drive, or one copy on a flash drive and another using a cloud-based service.
3. Ensure that at least one backup copy is stored offsite. You could store your external hard drive in a safe-deposit box or at a trusted friend or family member's house. Cloud storage is also considered offsite.

If a cloud service is one of your backup tactics, be sure to review carefully its policies and procedures for security and backup of its servers. Another good idea is to encrypt (that is, create strong passwords that only you know) to protect sensitive documents and your external drives.

So at the risk of sounding redundant (or driving the point home?), a good rule for data backup is to have at least three copies on at least two different formats, with at least one copy stored offsite. And more is always better.