

Managing A Concentrated Stock Position Wisely

The bear market was full of reminders of the perils of holding concentrated stock positions. In the financial sector alone, many former titans saw their share prices fall precipitously (and a few disappeared altogether). Though concentrated positions sometimes provide extraordinary gains, a broad mix of investments holds a lower probability of loss. That doesn't mean you should immediately sell a concentrated stock position and replace it with a diversified portfolio—there are tax costs and other factors to weigh—but it does argue for managing them wisely.

Even if you discount the likelihood that a particular holding might lose most of its value, stocks' volatility could limit your investment gains. "The Hidden Cost of Holding a Concentrated Position," a recent study by investment firm Robert W. Baird & Co., compares a hypothetical stock-and-bond portfolio to the 272 stocks that were in the Standard & Poor's 500 stock index over a 10 year period. The hypothetical portfolio, with 60% of assets in a broad mix of stocks and 40% in taxable bonds, outperformed most of the individual stocks, whose average volatility was four times that of the diversified holdings. (Volatility, often measured in terms of standard deviation, considers changes in the market price of an investment; the more sharply the price tends to rise and fall, the greater the stock's volatility.) While 160 of the stocks failed to keep up with inflation—and 104 lost 20% or more—the



hypothetical diversified portfolio produced a 45% gain for the decade, according to the Baird study.

One reason the diversified portfolio did so much better has to do with volatility's effect on compounded investment returns. The Baird study considers two hypothetical holdings that produced the same average annual returns during a two-year period, but had

very different levels of volatility. The first investment gained 50% the first year, but lost 30% in year two, for an average gain of 10% and a volatility of 40%. The second investment gained 15% and 5%, respectively—also an average 10% gain, but with volatility of just 5%. That makes a big difference in the performance of a \$1 million investment in each holding. The first would jump in value to \$1.5 million after one year before dropping back to \$1.05 million after the second year, for compounded annual growth of 2.5%. The second investment, in contrast, would have been worth only \$1.15 million after one year but \$1,207,500 after two—a compounded growth rate of 9.9%. Of course, it is important to remember that diversification does not ensure a profit or protect against loss in a declining market.

So if diversification tends to reduce volatility, and that in turn may translate into better results, why would anyone hang on to a concentrated stock position? There are many reasons, including legal restrictions on selling shares in an employer, but tax costs may be the biggest

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Financial Planning: It's Not Just About The Numbers

It's easy to assume that financial planning is all about numbers. Of course, certain numbers underlie every financial plan: cash flow, the value of retirement assets, anticipated college expenses for children, the purchase price of the ideal vacation home, the cost of a parent's caregiver—every client has unique goals, burdens, and challenges. It's a numbers game.

Important as they are, though, numbers are just the beginning.

The foundation of a strong relationship between a client and an advisor is qualitative, not quantitative. Understanding each other requires a continuous dialogue about the things in life that are most meaningful to the client.

Only by asking deeper questions can we truly know our clients, and understand the emotions behind their needs. With this deeper relationship, we can work with our clients to meet the concerns underlying their financial outlook: hopes for a sense of financial security, fears that a child's special needs may require support beyond the client's lifetime, and the wish to provide an education for children or grandchildren.

We believe that knowing our clients—understanding them as individuals—is the greatest strength of our planning services. We care about what drives you, whether it's a desire to be charitable, to see your children established and secure, or to simply feel confident as you navigate life's changes. This understanding allows us to design the best possible plan for you.

Florence Dupont, Ken Gutwillig,
 and Linda Schoenthaler

Are You Being Socially Responsible?

How can you invest to make money with a clear conscience about your investment choices? The concept of “socially responsible investing” (SRI) – also known as socially conscious, mission, ethical, or green investing – has taken hold in this country. According to a recent report by the Forum for Sustainable and Responsible Investment, a nonprofit group known as US SIF, SRI represents more than one out of every six dollars of managed assets in the U.S., accounting for as much as \$6.57 trillion.

But SRI requires more than a mere promise to recycle newspapers or to be kinder to strangers. SRI investors use three basic principles to guide their choices:

1. ESG. First and foremost, SRI advocates look to invest in companies that demonstrate the values that advocates hold near and dear to their hearts. This might include beliefs about the environment, consumer issues, religious protection, or human rights, to name a few. These areas of concern are often summarized as “environmental, social, and governance,” or ESG.

2. Shareholder advocacy. This involves attempting to discourage corporate decisions that could affect the core values of ESG adversely. Proponents hope to convince companies to improve their practices



and policies and act as good corporate citizens while still delivering long-term growth. These goals may be accomplished through various means, including starting a dialogue, filing resolutions for shareholder votes, educating the public, and attracting media attention to hot-button issues.

3. Community investing. This has become the fastest growing aspect of SRI with an estimated \$61.4 billion in assets under management in 2014.

With community investing, capital is directed to communities, here and abroad, that seek to provide services such as housing, education, health care, and child care.

Socially responsible investors come from all walks of life. They range from people investing in mutual funds that specialize in choosing companies with appropriate ethical and environmental practices, to hospitals that won't invest their endowments in tobacco companies, to public pensions emphasizing a commitment to reduce greenhouse gas emissions and factoring climate change into strategic planning.

In particular, mutual funds taking these approaches have experienced rapid growth during the past few years. According to US SIF, the number of ESG mutual funds in the U.S. grew from 333 to 456 from 2012 to 2014, with assets under management increasing from \$641 billion to \$1.93 trillion.

Before you jump on the SRI bandwagon, make sure this is the right path for you. We can help you investigate all the possibilities. ●

Whole Life Or Term? It's A Tough Choice

If you're shopping for life insurance, you'll find myriad policies with innumerable options and riders. However, individuals often face a choice between two common types of life insurance: whole life or term. While whole life provides permanent coverage and some cash value, it's normally much more expensive than a term policy that merely promises a death benefit if you die within a specified length of time. After years of steadily declining, the premiums for some term insurance policies have recently started to creep up, which could lead you to rethink your options.

Consider these differences between the two types of policies.

Whole life insurance. This is the traditional form of permanent life insurance. (Variations include “universal” life insurance and other cash-value policies.) The annual premiums are generally fixed when you buy the policy, which remains in effect for as long as you live if you continue to pay the premiums. In addition to providing a death benefit, the policy builds up a cash value on a tax-free basis. Typically, you're able to borrow against that value, or take the cash with you if you surrender the policy. If you decide to surrender the

policy, you will receive the accumulated cash value less any surrender charges or fees. But the premiums for whole life insurance are sharply higher than those of a term policy, particularly when you're younger and term insurance is relatively cheap.

Term life insurance. As the name implies, you can buy term insurance covering a specified term, usually 10 years or longer. You could tailor the length of a policy to the amount of time you project that you will need coverage, perhaps choosing to have it expire at your expected retirement date, when replacing your income

The Real Rules On Charitable Deductions

Cleaning out your closet could be a great way to cut your tax bill and be philanthropic at the same time. If you itemize deductions, you can write off charitable contributions of up to 50% of this year's adjusted gross income, and if you exceed that amount, you can carry over the remainder for future tax years. When giving personal property, you get the same benefits as an owner of a partnership, limited liability company, or S corporation when the business donates property to eligible charities. A C corporation can also take charitable deductions on its own tax return.

Still, Internal Revenue Service rules governing gifts of tangible personal property—anything you can see, touch, or feel, excluding land or a building—are complex, as Publication 526 reveals. Under the “Pease rule,” deductions for upper-income donors may be slightly reduced. You must keep copious records. Therefore, it's important to know the requirements and follow them carefully.

The size of your deduction depends on myriad factors, such as whether the donated property is worth less now than when new. A couple of examples include a late model used car and most items of clothing. With such gifts, you can generally deduct

the item's fair market value or street value. Websites like autos.yahoo.com can help you approximate what a car is worth, taking into account its age and condition. For clothing, the fair market price might be what you'd get selling to a thrift shop. For donations of household items, a deduction is only allowed if the item is in good condition.

When you give away non-business property that has appreciated, you may deduct its fair market value only if you have owned the property for more than a year, and the charity anticipates using it in a way related to its tax-exempt purpose. For instance, you qualify if an art museum accepts your artwork and agrees to display it. A big advantage of giving away appreciated collectibles such as fine art, vintage wines, and guitars signed by the Beatles, is that your profit from selling them would be taxed at 28%—much higher than the usual rate for capital gains!

You can't deduct nearly as much with gifts of appreciated business property or if the charity plans to sell your donation. In such instances, you can usually deduct only the asset's basis. For business property, such as outdated computers, that's the original cost minus depreciation write-offs you've taken. For personal assets

you've inherited, it's what the gift is worth on the day the executor values the estate—either the date of death or six months later. For a gift you've received, the basis is what the original owner paid. So if your great aunt gives you a white mink coat she bought in 1958 for \$250, that's all you're entitled to deduct if you donate the fur for auction at a church fair, even if the coat fetches more.

For every non-cash gift, you'll need a receipt or acknowledgment from the charity showing the date and location of the donation, and a reasonably-detailed description of the gift. For gifts of \$250 or more, the charity's written acknowledgment must also say whether you received goods or services in return.

With greater IRS scrutiny of high-income returns likely, it's wise to heed these rules

In addition, you must keep your own written records, including the terms of any conditions attached to your gift and how you figured your deduction. Deductions of more than \$500 require you to substantiate how and when you obtained the donated property, and your basis in it. If that's not available, you must explain why in an attachment to your tax return in order to get the deduction.

If you deduct more than \$5,000 for a single donated item or group of similar items, such as a coin collection, you'll need a written appraisal and the qualified appraiser's signature on IRS Form 8283, which you must file with your tax return. Someone from the organization that received your gift must also sign the form and indicate whether the charity intends to put the property to an unrelated use.

So give, and your magnanimity will be rewarded—as long as you keep good records and don't overestimate the value of your generosity. ●

becomes less of an issue. At the term's end, most policies let you renew at a higher premium. One main reason why term premiums are lower than those for whole life policies with the same death benefit is that term insurance doesn't have to divert part of what you pay to fund a cash build-up.

The bottom line. One common strategy for purchasing life insurance is to buy a term policy and invest the difference between that cost and what you would pay for a whole life policy. Of course, every situation is different. For instance, with the cost of term

insurance rising, you may prefer the peace of mind of having permanent insurance. But your choice doesn't have to be either/or; you could

combine both kinds of insurance as part of an overall financial plan.

Major life events such as the birth of a child or grandchild, the start of a new business venture, or a change in your personal health are reasons to review your life insurance coverage. We are happy to help you evaluate the

right mix of insurance for your unique situation. Please feel free to give us a call. ●



Keep Eyes On Estate Tax Proposals

In his 2015 State of the Union address, President Obama laid the groundwork for several significant estate tax changes, which were covered in greater detail in the administration's budget plan for the 2016 fiscal year. Although these proposals are a long way from being enacted, it makes sense to know some of the key concepts now. Here are several:

Capital gains: When you inherit assets, you currently benefit from a "step-up in basis" to the fair market value (FMV) of the assets on the date of death. Say you receive stock acquired for \$5,000 that's worth \$15,000 when you inherit it—your basis is \$15,000. Sell the shares for that amount and you'll owe nothing in taxes. The \$10,000 appreciation in value is tax-free forever.

Under the president's proposal, this "trust fund loophole," so-called because it's often used in conjunction with trusts, would be closed. Instead, you would owe tax on the difference between the original basis and the FMV on the date of death through a "deemed sale." In our example, that would mean

a taxable gain of \$10,000. However, the proposal does allow a taxable exclusion on such gains of \$100,000 per person (\$200,000 for a married couple).



Estate and gift tax exemptions: The president would roll back the estate and gift tax exemptions to 2009 levels. Thus, the \$5.43 million exemption in 2015 would revert to a \$3.5 million exemption, as would the generation-skipping tax exemption. In addition, whereas the current exemption can be used for a combination of gifts made while you're alive and at your death, the new \$3.5-million exemption would only apply to estates. There would be a separate \$1-million lifetime exemption for gift taxes. Finally, the top estate tax

rate would be raised from 40% to 45%.

Grantor retained annuity trusts: The grantor retained annuity trust (GRAT) has been in the crosshairs of the Obama administration for some time. With this estate planning technique, you create an irrevocable trust for a specified term, funding it with assets, and then an annuity is paid to you based on IRS-approved interest rates. Eventually, the remaining assets go to your beneficiaries tax-free.

The president's proposals would curtail the tax benefits by (1) requiring a minimum term of 10 years, (2) imposing a minimum remainder interest of 25% of the assets transferred to the trust, or \$500,000, whichever is greater, and (3) prohibiting the grantor from participating in a tax-free exchange of assets with the GRAT. These changes would effectively eliminate future GRATs.

Of course, you shouldn't overhaul your estate plan based on these proposals, but do be prepared to update your plan if it looks as if they may become law. ●

Managing Stock Wisely

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stumbling block. If you sell shares that have appreciated significantly, you could find yourself paying up to 20% tax on long-term capital gains on the proceeds (unless you have large capital losses from this year or a prior year to offset your gains)—and that knocks a large hole in a new, diversified portfolio.

There are several alternatives to selling all at once. You might offset some of the risks by avoiding that holding's company and industry in the rest of your portfolio. You could divest your shares gradually in order to stretch out your tax liability. Very wealthy investors may be able to put a portion of concentrated holdings into an exchange fund, which avoids immediate taxes and gives

investors shares in a diversified portfolio. Using some of the stock position to fund charitable goals could provide tax advantages and income, especially if you donate the lowest basis shares. Company insiders might use a preprogrammed selling program known as a 10b5-1 to unload restricted shares.

All of these possibilities involve complex planning issues and need to be considered in view of your overall financial goals. For example, if the current capital gains tax rate is expected to rise, that could make it advantageous to incur

Five Ways To Manage A Concentrated Stock Position

1. Avoid similar holdings in the rest of your portfolio
2. Divest your shares gradually to stretch tax liability
3. Fund charitable goals with part of your holding
4. Put a portion of the stock into an exchange fund
5. Use a 10b5-1 preprogrammed selling program

those taxes now, not later. We can work with you to assess the vulnerability of a concentrated stock position and help you manage it wisely. ●

¹The hypothetical stock portfolio in the Baird study had 12% of assets in large-cap growth, 14% in large-cap value, 8.5% and 3.5% in mid-cap and small-cap shares, respectively, 14% in international holdings, and 8% in a mix of "satellite" investments (emerging markets, high-yield bonds, commodities, and real estate).