

The Sensenig Capital Advisor Letter



Sensenig Capital Advisors \ Wealth Management

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What's "New" about a New Normal?

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The 2008 global market crisis and the struggling economy have left many investors fatigued. Despite two years of strong equity returns, some investors have been slow to regain market confidence. Many are accepting the talk about a "new normal" in which stocks offer lower returns in the future. This new normal phrase has gained a fair amount of attention more recently. It refers to the idea that the U.S. economy will be characterized by growth of just 1 or 2 percent for a long stretch of years. That is well below the healthy growth rate of 3 or 4 percent that was the norm just a few years ago.

The concept of a new normal is anything but new. In fact, throughout modern history, periods of economic upheaval and market volatility have led people to assume that life had somehow changed and that new economic rules or an expanding government would limit growth. What they could not see was how markets naturally adapt to major social and economic shifts, leading to new wealth creation. While we all very well know there is no financial crystal ball to rely on, we can quite legitimately argue that the economy

will revert back to its long-term growth trend. We do not have to automatically assume that sudden shocks to the system in the short-term means a permanent diversion from that long-run trend. As we have stated before people have a tendency to overreact to economic news.

SECTION HIGHLIGHTS

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No one knows what the future holds, which brings the concept of "normal" into question. What exactly is the status quo in the markets?

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Let's look at other periods when investors had strong reasons to give up on stocks, and consider the parallels to today:

1932: The US stock market had just experienced four consecutive years of negative returns. A 1929 dollar invested in stocks was worth only 31 cents by the end of 1932. Hopes were sinking during the Great Depression, and many people felt as though the economy had permanently changed. Many investors left the market, and some would not return for a generation. Amidst what is considered the roughest economic time in US history, the markets looked ahead to recovery. See the following table:

US Stock Market Performance after 1932*			
	5 Years	10 Years	20 Years
Annualized Return	15.35%	10.07%	13.19%
Growth of \$1	\$2.04	\$2.61	\$11.92

*All stock market returns based on CRSP 1-10 Index.

Past performance is no guarantee of future results. Indices are not available for direct investment. Their performance does not reflect expenses associated with the management of an actual portfolio.

1941: World War II was raging, and the US had just entered the conflict. The US stock market had experienced two consecutive years of negative performance, and the economy had shown signs of sliding back into depression. Although conversion to a wartime economy would revive industrial production and boost employment, investors struggled to see beyond the conflict. Many expected rationing, price controls, directed production, and other government measures to limit private sector performance. As we can see below, the market performed favorably.

US Stock Market Performance after 1941*			
	5 Years	10 Years	20 Years
Annualized Return	18.63%	16.67%	16.29%
Growth of \$1	\$2.35	\$4.67	\$20.47

1974: Investors had just experienced the worst two-year market decline since the early 1930s, and the economy was entering its second year of recession. The Middle East war had triggered the Arab oil embargo in late 1973, which drove crude oil prices to record levels and resulted in price controls and gas lines. Consumers feared that other shortages would develop. President Nixon had resigned from office in August over the Watergate scandal. Annual inflation in 1974 averaged 11%, and with mortgage rates at 10%, the housing market was experiencing its worst slump in decades. With prices and unemployment rising, consumer confidence was weak and many economists were predicting another depression but U.S. equity market performance proved otherwise, as indicated below.

US Stock Market Performance after 1974*			
	5 Years	10 Years	20 Years
Annualized Return	17.29%	15.92%	14.89%
Growth of \$1	\$2.22	\$4.38	\$16.07

1981: The stock market had delivered strong positive returns in five of the last seven calendar years, and the two negative years (1977 and 1981) were only moderately negative. Despite these results, investors were weary from stagflation, which was characterized by high annual inflation, anemic GDP growth, and unemployment, and from fears of another economic downturn. In late 1980, gold climbed to a record \$873 per ounce—or \$2,457 in 2010 dollars. (By comparison, spot gold reached \$1,256 per ounce in 2010.) Memories of the 1973–74 bear market lingered. A 1979 BusinessWeek cover story titled “The Death of Equities” claimed inflation was destroying the stock market and that stocks were no longer a good long-term investment. The following table is certainly evidence to the contrary.

US Stock Market Performance after 1981*			
	5 Years	10 Years	20 Years
Annualized Return	18.82%	16.58%	14.54%
Growth of \$1	\$2.37	\$4.64	\$15.11

1987: On “Black Monday” (October 19, 1987), the Dow Jones Industrial Average plummeted 508 points, losing over 22% of its value during the worst single day in market history. The plunge marked the end of a five-year bull market. But in the wake of the crash, the market began a relatively steady climb and recovered within two years. The effects of the crash were mostly limited to the financial sector, but the event shook investor confidence and raised concerns that destabilized markets would increase the odds of recession. Again, U.S. equity markets performed favorably, as indicated in the table below.

US Stock Market Performance after 1987*			
	5 Years	10 Years	20 Years
Annualized Return	16.16%	17.75%	11.89%
Growth of \$1	\$2.11	\$5.12	\$9.46

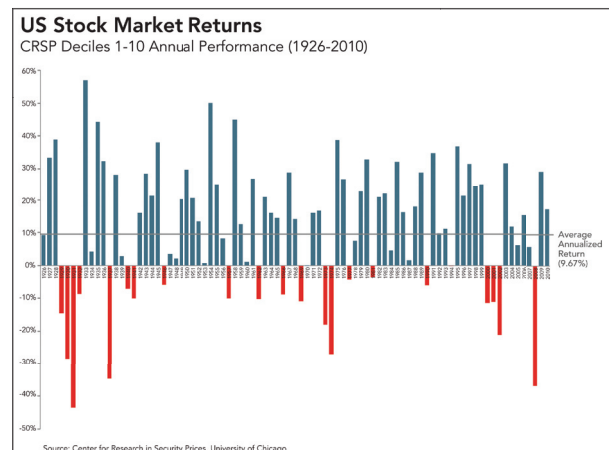
2002: By the end of 2002, investors had experienced the stress of the dot-com crash in March 2000, the shock of the September 11 attacks, and the early stages of wars in Afghanistan and Iraq. Although October 9, 2002, would ultimately mark the market’s low point, investors had endured three years of negative performance and an estimated \$5 trillion in lost market value. A younger generation of investors had experienced its first taste of old-world risk in the “new economy.”

US Stock Market Performance after 2002*			
	5 Years	10 Years	20 Years
Annualized Return	13.84%	—	—
Growth of \$1	\$1.91	—	—

2008–TODAY: The market slide that began in 2008 reversed in February 2009—gaining 83.3% from March 2009 through 2010. Despite two years of strong stock market returns, memories of the 2008 bear market and talk of the “lost decade” have led many investors to question stocks as a long-term investment. But earlier generations of investors faced similar worries—and today’s headlines echo the past with stories about government spending, surging inflation, deflationary threats, rising oil prices, economic stagnation, high unemployment, and market volatility. This is not to say the decade ending 2012 will perform as well as these prior examples; likely not.

Of course, no one knows what the future holds, which brings the concept of “normal” into question. What exactly is the status quo in the markets?

The chart below shows the annual performance of the US market, as defined by CRSP deciles 1-10. Since 1926, there have been only four periods when the stock market had two or more consecutive years of negative returns. In addition, annual returns are rarely in line with the market’s 9.67% long-term average (annualized). The most obvious normal may be that, over time, stocks offer expected returns reflecting the uncertainty and risk that investors must bear. What’s new about that? **S**



Jeremy Brenn Achieves the CFP Designation!

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We are pleased to announce that Jeremy Brenn recently received the highly sought designation of Certified Financial Planner (CFP®). To earn this designation, candidates must meet several requirements including mastering nearly 100 topics of integrated financial planning in major areas such as investments, retirement, estate planning, income taxation, insurance, and employee benefits. To fulfill the education requirement Jeremy completed over a year of intensive coursework and passed the rigorous 2-day, 10-hour CFP® Board Certification Exam.

Congratulations to Jeremy for the knowledge and expertise he brings to all of our highly-valued clients.



THE MISSION OF THE CFP BOARD

The mission of Certified Financial Planner Board of Standards, Inc. is to benefit the public by granting the CFP® certification and upholding it as the recognized standard of excellence for competent and ethical personal financial planning.

WHAT IS FINANCIAL PLANNING?

Financial planning is the process of meeting your life goals through the proper management of your finances. Life goals can include, among many things, saving for higher education, planning for retirement, properly

planning your estate, or prudently managing your income tax situation.

The financial planning process takes a “big picture” look at where you are financially, enabling you to work out where you are now, what you may need in the future and what you must do to reach your goals.

The process involves gathering relevant financial information, setting life goals, examining your current financial status and coming up with a strategy or plan for how you can meet your goals.

THE BENEFITS OF FINANCIAL PLANNING

Financial planning provides direction and meaning to your financial decisions. It allows you to understand how each financial decision you make affects other areas of your finances. You can also adapt more easily to life changes and feel more secure that your goals are on track for the future.

HOW WE INCORPORATE FINANCIAL PLANNING

We partner with you to provide a customized investment plan based on your ability, willingness, and need to take risk. We understand your goals and dreams are unique, and we treat them as such.

Combining investment management with wealth planning, we provide a holistic approach that enriches the client experience and goes well beyond traditional money management.

Our wealth planning technique allows us to partner with you in order to comprehend your entire financial picture including values, personal interests, key relationships, and objectives for the future. How do we accomplish this? It begins with you. **S**

A Once in a Lifetime Opportunity: Taking Advantage of Increased Gifting Exemptions

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Only one year remains for the greatest gift giving opportunity since the gift and estate tax laws were enacted. Have you made plans yet to take advantage of it?

As most of you know, in December 2010 Congress shocked almost everyone by increasing the exemption from federal gift taxes from \$1 million to \$5 million. This law is scheduled to expire on January 1, 2013 when the gift tax exemption is supposed to return to \$1 million. Assuming that we return to gift and estate tax rates of 50%, and a gift and estate tax exclusion of \$1 million, as currently scheduled, failing to use your exemption by the end of 2012 could cost your family over \$4 million in taxes. This cost doesn't even take into account any income and appreciation on the gifted assets.

GETTING STARTED WITH PLANNING

How do you get started with a gifting plan? Here's a suggestion - meet with your financial advisor (FA) as soon as possible. If your FA provides financial planning services, all the better. Work with your FA to make some reasonable assumptions about future investment returns and figure out how much of your net worth you need to retain access to for the rest of your life without jeopardizing your standard of living. You should consider gifting all or a part of any excess to your children or other heirs before the law expires on December 31, 2012.

After you and your FA decide what you can afford to gift, meet with a lawyer who is an expert in estate planning and the federal income, gift, estate and generation skipping transfer tax laws. Working together with your FA and your CPA, ask your lawyer to develop a gifting

plan that you can implement before the end of 2012. As you develop your plan, think about the following:

- Do you want to continue to use any of the assets you are considering gifting, such as a vacation home?
- Should the gifts be outright so that the recipient has unlimited access to the funds, or should the gifts be in trust so that they can be shielded from creditors, including spouses?
- Should the gifts be structured to benefit multiple generations of your family, or just your children?
- Who should pay the taxes on the income earned by the gifted assets?

Depending on the answers to these and other questions, your lawyer should be able to provide you with several different options for achieving your goals. Once you have decided on the structure of the gifts, you will

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Michael's practice involves a broad range of matters, many of which are tax related, including:

- Estate and gift tax planning
- Estate and trust administration
- Resolution of tax controversies

Michael also counsels businesses and business owners on commercial matters such as:

- Business succession planning
- Mergers and acquisitions

Michael is the Managing Partner of the firm's Blue Bell office and is a member of the firm's Executive Committee.

need to select the specific assets to be gifted. Ideally, the assets you gift will have these attributes:

- Significant potential for appreciation or income production, or both.
- High income tax basis - meaning that the asset has not appreciated significantly since you acquired it.

A benefit of gifting, in contrast with transferring assets at your death, is that the appreciation and income earned on the gifted assets are also removed from your estate. With estate tax rates historically around 50%, this means that every dollar of appreciation and income associated with the gifts you make could save you fifty cents in death taxes.

THE POWER OF THE GRANTOR TRUST

One way to turbo charge your planning is to make your gift to a trust known as a “grantor trust”. A grantor trust is a trust designed to remove assets from your estate for estate tax purposes, while continuing to treat you as the owner of the assets for income tax purposes. This makes you responsible for the income tax on the assets owned by the trust. It also permits the assets in the trust to grow free of taxes, while you further reduce your estate by the income taxes associated with the trust’s assets. Moreover, under current law, paying the income taxes associated with assets in a grantor trust is not considered a gift from you to the trust.

Let’s look at a simple example of the grantor trust at work. Assume you make a gift of \$1 million to a grantor trust. Further assume that the gifted assets are invested, return 5% per year in interest income and that your marginal income tax rate is 35%. At the end of ten years, the amount in the trust has grown to \$1,628,895. The total income tax associated with the interest earned on the gifted assets is \$220,113 (\$628,895 mul-

tiplied by 35%). Because the trust is a grantor trust, you are responsible for the income tax liability, but the IRS does not view your payment of the tax as a gift to the trust. By structuring the trust as a grantor trust you have permitted the gifted assets to grow faster (and outside of your taxable estate) and reduced your own taxable estate by paying the income tax on the gifted assets. Your CPA or financial planner can help you better calculate the power of the grantor trust as an estate planning technique, but suffice it to say, over time the federal estate tax savings can be extraordinary.

LOCKING IN THE EXEMPTION AND RETAINING ACCESS: SPOUSAL ACCESS TRUSTS

You might be reading this article thinking that you have enough money to worry about estate taxes, but not enough money to start gifting assets to your children. Recent difficulties in the economy and uncertain investment returns have many people concerned that they are not sufficiently wealthy to gift their assets away, yet the risk that gift and estate tax exemptions may revert back to \$1 million concerns them.

Is there anything that can be done to take advantage of this historic window of opportunity for estate planning without losing access to your assets? One possibility worth considering is to make a gift to a trust that benefits your spouse during your spouse’s lifetime and uses your lifetime gifting exemption. Your spouse can be named as a trustee along with an adult child or someone else friendly with your spouse and you can permit distributions to your spouse or for your spouse’s benefit for any reason considered appropriate by the non-spouse trustee.

Like any estate planning technique, this idea is not without possible downsides. If your spouse dies before you, you lose the indirect access you had to the gift-

ed property through your spouse. Similarly, if you and your spouse have marital difficulties, your indirect access will also be cut off.

If these risks do not concern you and you are intrigued by the possibility of locking in the benefits of the exemption, then you might also want to consider the possibility of your spouse creating a similar trust for your benefit. The IRS has a rule prohibiting you and your spouse from attempting to derive an estate tax benefit by creating reciprocal trusts, but it is possible to navigate around that obstacle. A skilled estate planning lawyer should be familiar with this issue and should be able to help you find a solution for it that is acceptable to you.

RELYING ON PORTABILITY CAN BE DANGEROUS

No discussion of the new tax law would be complete without a brief mention of “portability”. Simply put, portability means that if your spouse dies and fails to use any portion of his or her estate tax exemption, then the unused amount is available to you as the surviving spouse.

Prior to the 2010 law, gift and estate tax exemptions were personal, so if they were not used during your lifetime the exemptions were lost. This meant that a person who failed to properly plan his affairs, either by not having his lawyer prepare the correct documents or not having his assets properly titled, could lose the benefit of his exemption from federal death taxes.

The purpose of portability is to allow the use of both spouses’ exemptions even in cases where a couple failed to do proper estate planning. As an example, assume Joe and Mary each have \$5 million of assets and Joe dies in December, 2011 with a Will that leaves all of his assets to Mary. Further assume that Mary dies in December, 2012. Without portability, Mary would have a \$10

million estate, but only a \$5 million exemption from federal estate taxes. The \$5 million by which her estate exceeds her exemption would be taxed at the current 35% federal estate tax rate and her estate would owe the government \$1.75 million in federal estate taxes.

Portability permits the executor of Joe’s estate to make Joe’s \$5 million unused exemption available to Mary at her death. The result is that Mary’s \$10 million estate is protected from federal estate taxes because portability makes Mary’s exemption of \$5 million and Joe’s unused \$5 million exemption available to Mary when she dies.

Although one would think that portability makes estate tax planning unnecessary in many cases, relying on portability is risky. First and foremost, like all aspects of the 2010 law, portability expires on December 31, 2012. As a result, it only benefits a married couple if both spouses die after January 1, 2011, and before January 1, 2013. In addition, the example of Joe and Mary above assumes that the \$5 million Mary inherited from Joe at his death did not appreciate or produce income. If Joe had engaged in traditional estate tax planning and, at his death, left his \$5 million in trust for Mary’s benefit, then the \$5 million and all appreciation and income on that gift would be exempt from federal estate taxes at Mary’s death. Relying on portability before it becomes a permanent part of the tax law is not advisable.

START YOUR PLANNING NOW!

If you are at risk to pay federal estate taxes, call your financial advisor soon. Ask your FA to get the ball rolling on organizing your advisors to help you take advantage of an opportunity that may prove to be “once in a lifetime”. When 2013 rolls around, you’ll rest easy knowing that your assets will end up benefitting your heirs while potentially saving millions of dollars in taxes.



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Creating wealth is one thing. Preserving it is another.

You want your financial resources to help achieve what is important to you in life—but making sound, effective financial decisions is difficult in our increasingly complex world. Many find the media as their source for investment guidance. Unfortunately, much of the daily media hype only serves to distract investors from achieving the results they seek. Where can you turn for a solid solution to the problem?

Sensenig Capital exists to help financially successful people organize, preserve, and manage their wealth, allowing them to focus on what they are most passionate. How do we accomplish this? It begins with you.

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