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# Trust UPDATE



August 2012

## Sudden Wealth

**S**tate-run lotteries have been successful for a reason; nearly everyone loves the idea of suddenly becoming rich, suddenly joining “the 1%.” The allure of buying whatever one needs, without regard to budget or fear of bill collectors, is powerful. So powerful that, for many, the long odds against winning a lottery can be overlooked.

But lotteries are not the most common source of sudden wealth. Large sums may come in the form of a lump sum distribution of retirement benefits from an employer, from an insurance settlement, or from the sale of a business or investment real estate. Another source to consider is inheritance.

In these cases, the recipient of new wealth will face unfamiliar tax and investment decisions. Such decisions are best addressed with help from a professional. Psychologists have found that there also can be an important emotional component to acquisition of large sums. In fact, Web MD has identified something called “sudden wealth syndrome,” a set of behavioral changes that suggest a medical consultation may be called for. (See the box at left for details.)

If you become suddenly wealthy, you need to prepare yourself for your new life, and you need to take steps to make it last. If you plan to make your heirs suddenly wealthy, many of the same considerations apply. In that case, you can take the initiative to see to it that no misfortune accompanies their good fortune.

**Go slowly**

The first steps that one needs to take upon receiving a windfall involve setting priorities and developing strategies. A realistic assessment of long-term needs may not be easy, but it provides an important foundation. Matching resources to those needs comes next, followed by a strategy for investing and managing one’s new assets. Until these steps have been taken, major temptations such as the following should be avoided:

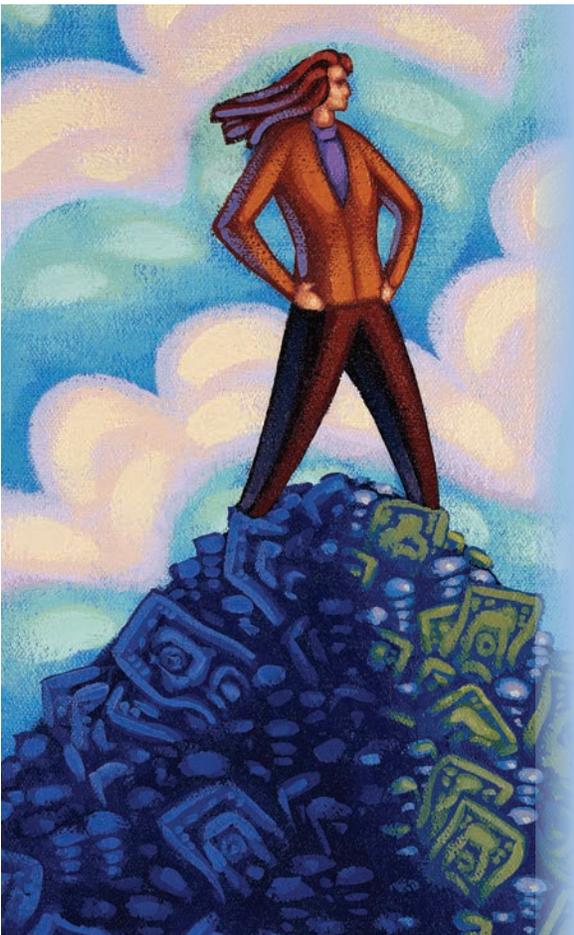
**Early retirement.** As alluring as jumping off the treadmill of daily work life may be, one also needs to plan for longevity.

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**Signs of “sudden wealth syndrome”**

A sudden change of financial circumstances can be the source of a surprising amount of stress, even when the change is for the better. Behavioral worries to watch for include:

- recurrent money-related ruminations;
- being afraid to tell friends about the new financial status;
- sleep disorders;
- guilt over the good fortune, inhibiting decision-making and undermining pleasure;
- development of “ticker shock,” an obsession with the performance of the stock market;
- fears of loss of control, paranoid thinking, concern about being exploited by others;
- irrational fear that the sudden wealth will evaporate as quickly as it arrived.



## Sudden wealth . . . continued

You need enough financial resources to cover the unexpected as well as what you can foresee.

**Relocation.** Changing domicile is a major life decision. Before permanently moving to a new city or state, it may be wise to live there temporarily, in order to become confident that it will be all that is hoped for.

**Major gifts.** Family members, friends, even charities may approach the recipient of sudden wealth with requests for help. Keep in mind that a gift is forever, and the income that gift might earn goes along with it. Be certain that you really can afford to part with the capital. Don't overlook the fact that major gifts to friends and family may trigger gift tax obligations as well.

### If you have come into a fortune

We have quite a bit of experience with wealth management. We know all about financial transitions and attendant emotional adjustments. When you come into significant sums, call upon us for:

- personal investment accounts, with asset allocation planning, unbiased investment advice and fees linked to account value (not transactions);
- revocable living trusts, for an added measure of financial flexibility, including protection in the case of disability and probate avoidance;

- rollover IRAs to extend the tax-deferral benefits for your retirement money.

### If you will be giving a fortune

If your estate plan includes a substantial legacy for a younger family member who lacks full financial maturity, consider using a trust for the bequest. Your trust will be a gift of more than financial resources. You will be including our investment and financial management expertise as well. A gift or bequest in trust can provide for a lifetime of financial security. Approaches to discuss with your trust officer include:

- Gifts-to-minors trusts;
- Incentive trusts;
- Sprinkling trusts; and
- Spendthrift trusts.

### Talk to us

Wealth management is about taking control of your assets, as well as letting go of control, so you can enjoy your life. We can help you with all phases of your asset management. If you would like to learn more about how our personal trust services might help you to conserve and manage your wealth, we invite you to meet with us in person. We look forward to meeting with you to discuss your goals and requirements. □



### Five red flags

If you are seeking help in managing a substantial sum, you likely will interview a number of potential advisors. How do you find an advisor with the client's best interest in mind? Here are some pointers for the process.

**Ask questions.** You need to know about past returns, whether any returns are guaranteed, and when you can get your money out.

 If someone downplays such worries, he or she may not be right for you.

**Ask for written materials.** You want to review longevity of the firm and the credentials of the advisors with whom you'll be working.

 Watch out for firms whose history you can't easily trace, for gaps in history and for unfamiliar credentials. You can check on professional certifications with the organizations that issue them.

**Bring a trusted advisor along for the interview.** Your attorney or accountant will provide additional perspective, and he or she may spot issues that you miss.

 If there is resistance to your bringing an advisor along, or if you are told not to take notes, be wary. You need privacy; the firm that you are interviewing should not.

**If it sounds too good to be true, it is too good to be true.** Ask yourself, "Why is this opportunity being presented to me?"

 Grandiose claims, answers that don't make sense and material omissions are all signs of trouble.

**Take your time.** Anything worth investing in today will still be worth investing in tomorrow.

 A salesman who is pushing for a rapid signature is being unprofessional and, perhaps, unethical. Don't invest in anything if you can't take time to discuss it with family members.



# Does the Fed move the market?

The great temptation for investors is to “time” the market, to buy at the bottom and sell at the top. Especially when overall returns are poor, the temptation can be very strong. However, calling market tops and bottoms with any degree of accuracy is chancy at best. Studies have long shown that missing as few as the five best days in a market can cut total return for a year by half or more. Hence, the conventional wisdom that “time in the market is more important than timing the market.”

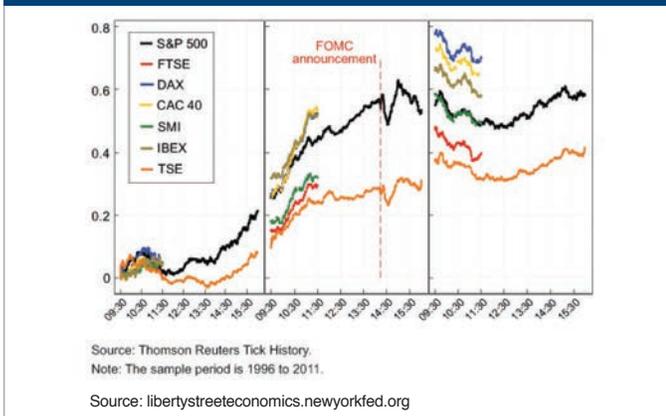
But what if you knew with confidence which days lead to excess market returns? A recent staff paper by economists at the Federal Reserve Bank of New York suggests that the exceptional days have been identified.

## The FOMC announcements

Eight times each year the Federal Open Market Committee (FOMC) of the Federal Reserve Board meets to set monetary policy. Since 1994, the outcomes of the meetings have been announced publicly at scheduled intervals. The economists looked at the performance of the S&P 500 during the three-day window surrounding those announcements.

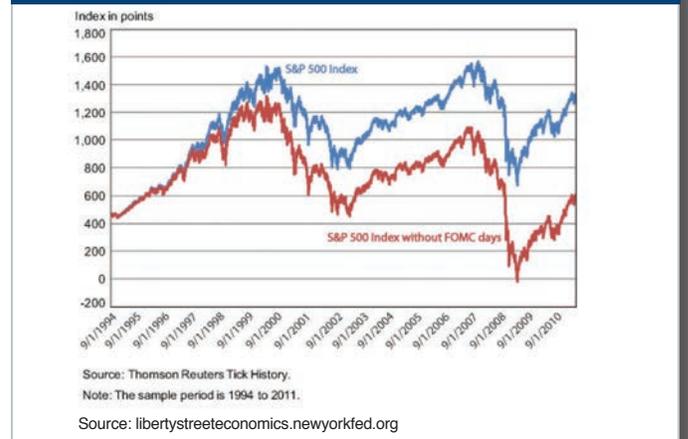
They found a persistent, abnormal rise in stock prices in the 24 hours preceding the FOMC announcements. Interestingly, the increase did not continue after the announcement, nor was it dependent upon the announced direction for interest rates. What’s more, the phenomenon also was observed in international markets. See the graph below for the composite returns for the day before the announcement.

Average Cumulative Returns on International Stock Market Indexes around FOMC Announcements



According to the researchers, “more than 80% of the equity premium [in the S&P 500] has been earned over the twenty-four hours preceding scheduled FOMC announcements.” The graph in this column shows what that means over the long term. The blue line in the graph is the S&P 500 Index since 1994, and the red line is the same index excluding just the 24 hours before a Fed announcement. Without the gains from the 24-hour window, the S&P 500 would be at 600 today, instead of around 1,300.

The S&P 500 Index with and without the Twenty-four Hour Pre-FOMC Returns



## What does it mean?

The researchers were surprised by these results and were unable to explain them with existing models of investor behavior.

Monetary policy is a shifting variable that investors must factor into their decisions. FOMC announcements are the moments when the uncertain becomes certain, at least until the next announcement. Apparently, as that moment of clarity approaches, sellers become less willing to sell, as they await the resolution. Buyers may be extra optimistic, hoping that the next Fed action is more likely than not to be stimulative.

Whatever the reasons behind the phenomenon, it appears that owning stocks the day before a Fed announcement is likely to be a good idea. Now that professional traders also know this secret, the pattern might become even more pronounced. □

## Here come the new ACA taxes

Always an essential element of portfolio planning, taxes are about to become even more important to those at the upper end of the income spectrum. Temporary tax cuts enacted during the Bush administration are scheduled to expire at the end of this year, and a cloud of political uncertainty hangs over them.

What is already certain, however, is that two new taxes will go into effect in 2013, as a result of the Supreme Court's validation of the Affordable Care Act (ACA) earlier this year. An additional 0.9% Medicare tax will apply to wages in excess of \$200,000 (\$250,000 for marrieds filing jointly). This applies to the employee only, not to the employer. Also, a 3.8% additional tax will apply to investment income above those thresholds.

"Investment income" will include interest, dividends, rents, royalties and capital gains. Pension income, IRA distributions and municipal bond income will not be hit by the new 3.8% tax. The taxable portion of annuity payments will be subject to the tax unless they are part of a company pension plan.

Note that because the threshold is keyed to adjusted gross income (AGI), having substantial itemized deductions will not affect this tax—even if a loss brings taxable income down to zero! Also, the capital gain on the sale of a personal residence could be taxed if it is larger than the \$250,000 exclusion (\$500,000 for couples).

### Examples

John and Mary (the example is fictitious) have pension and Social Security income of \$80,000 and investment income of \$170,000. They will not owe additional tax, because their total AGI is right at the threshold.

Now assume that the couple takes a \$60,000 withdrawal from their IRA. IRA withdrawals are not hit by the 3.8% tax, but they will be added to the couple's AGI. That pushes \$60,000 of their investment income into the taxable zone.

### Portfolio impact

The prospect of higher taxes could make municipal bond income even more attractive once we get to 2013. That could push up prices for muni bonds, driving down yields and increasing the spread compared to taxable instruments.

The opposite effect might be seen with dividend-paying stocks. Dividends will be less tax-efficient than capital gains. If investors come to value dividends less highly, the prices of such stocks may do less well.

One way to take more control over one's tax exposure is to convert traditional IRAs to Roth IRAs. That will eliminate the need for required minimum distributions from the IRA, which might trigger excess taxes. What's more, distributions from the Roth IRA are potentially tax free, and as such they would not increase AGI and the taxes on investment income. □

## The challenge:

### *How to make your wealth last?*



A trust plan may be the answer for you.  
Come see us today.



**Kirk Hosler**  
Senior Vice President & Trust Officer  
(815) 332-8872  
kirkh@stillmanbank.com



**Jeffrey Hartle**  
Vice President  
(815) 332-8843  
jeffh@stillmanbank.com

**Stillman**  
BANK

Trust & Asset Management  
8492 E. State Street • Rockford, IL 61108  
815-332-8100

www.stillmanbank.com