IN THIS ISSUE

Estate planning
Trust services 101
A short guide
Investments
How high can stocks go?
Social Security
Taxes on benefits

Trust UPDATE

Stillman BANK

February 2021

Trust services 101

An introductory guide

People with money to invest are often self-reliant, well enough informed to be able to sort through sales pitches and make up their own minds. They follow the financial press and apply their life experiences as they weigh their investment decisions.

But sometimes people cannot be do-it-yourself investors. Sometimes they don't want to be. In certain situations it's desirable, even essential, to choose an investment manager. And in making that choice, more and more people are looking for a source of investment guidance that is objective and unbiased. Rather than being on guard for hidden agendas and conflicts of interest, they are looking for an arrangement that is, under the law, structurally immune to such a development.

That's the financial service that we offer.

What we are

We are a *corporate fiduciary.* That means that we are a business organization that is permitted, under the law, to serve as trustee and administer investment programs for individuals, families, businesses, and endowments. For this service we are compensated by reasonable annual fees, tied to the market value of the funds in our care. Our operations are subject to a variety of internal and external regulatory oversights.

But what most clearly sets us apart from our competition are the values that we live by, the code of fiduciary responsibility, the high standards of trusteeship.

Trustworthy by design

The list of specific duties expected of a trustee is extensive—preserve and protect trust assets, invest and administer with care, maintain records, keep beneficiaries informed, deal with beneficiaries impartially, and so on. Every decision made and action taken by a

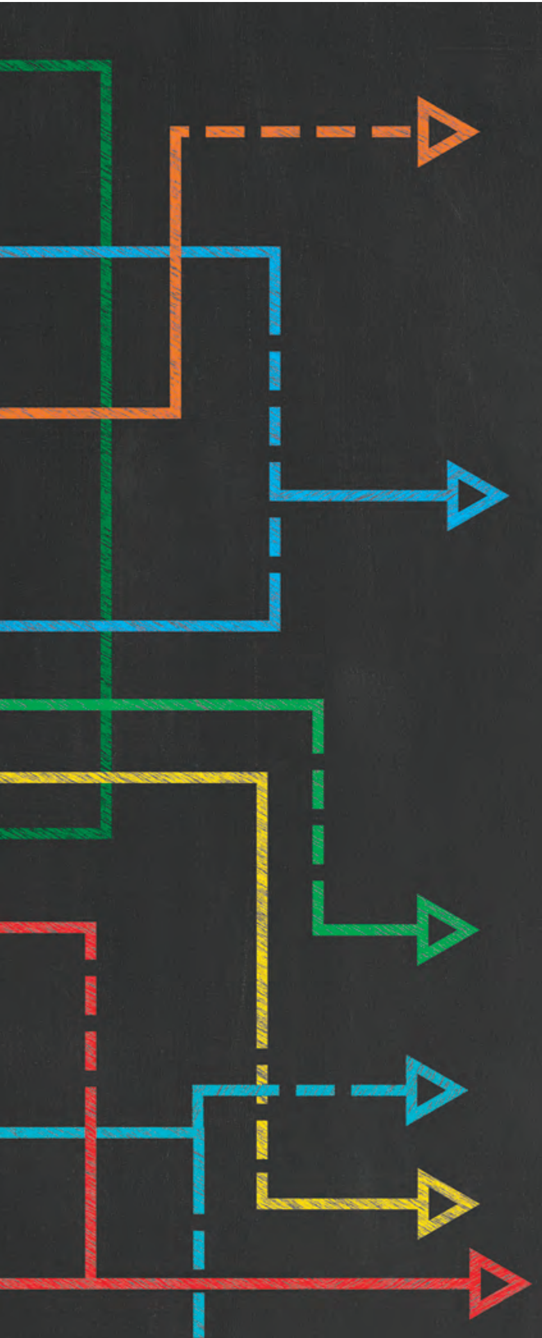
trustee is evaluated against a standard of *fiduciary duty*, which may be summarized as follows:

- To take just as much care of the trust property as a prudent businessperson would take of his or her own property.
- Not to make a penny of personal profit out of the trust. (The compensation of a professional trustee is limited to the trustee's fee.)

The trustee must be faithful to the trust and its purposes while remaining loyal to the trust client or the other beneficiaries. Conflicts of interest must be avoided. Conflicts that cannot be avoided must be resolved in favor of the trust and its beneficiaries. Always, and in all ways, a trustee must be a faithful steward, never engaging in self-dealing, never acting in its own interests.

If this all sounds rather old-fashioned, that's a criticism that we welcome. Because it is these high standards of stewardship, in the final analysis, that contribute so significantly to our clients' financial peace of mind.

If you already use our asset-management services, you know about these benefits. If you don't, there's no time like the present to find out.



A short guide to our trust and investment services

One of the great strengths of trust planning is the ability to tailor the plan to respond flexibly to current and future family financial needs. We emphasize personalized financial management.

Portfolio supervision. Serious investing is a full-time job. Our investment advisory and investment management services put experienced investment professionals on your side. The officer assigned to your account will work with you to establish an investment strategy suited to your personal goals and circumstances. Asset allocation planning will be employed to optimize your portfolio, reducing investment risk through diversification.

Lifetime financial management. The next step in comprehensive financial protection employs *a revocable living trust.* We begin by developing an investment policy for the trust, based upon your requirements. We will implement that plan, providing continuous portfolio supervision, reinvesting or distributing trust income as directed. As trustee, we can move beyond the investment sphere, arranging to pay household bills and taxes on your behalf. A revocable trust provides financial protection in the event of incapacity and has valuable estate planning aspects as well.

IRA rollovers. People who sell their businesses or investment real estate generally have to pay income tax on their capital gains. By contrast, people receiving lump sums from company retirement plans can choose to pay income tax immediately or execute a tax-deferred rollover. With their tax-deferred nature, IRA rollovers present somewhat unusual investment issues, which need to be addressed in the context of a full review of financial resources.

Charitable trusts. Thoughtfully designed trusts can provide financial protection for you or for family members as well as substantial support for your favored charity. Significant tax benefits may be available as well.

Estate settlement. The job of estate settlement is not an "honorary" one; it is a complex series of steps that need to be handled properly. Whether your estate will be large or small, you should not put this task into inexperienced hands. Your will can designate us to handle this critical responsibility.

Testamentary trusts. A legacy in trust, whether for a surviving spouse, a child, or other family members, can provide for a lifetime of financial security through careful, professional management.

Would you like to know more?

Trusts remain mysterious to many, but they need not be. Economic uncertainty, tax reform proposals, longevity, and a range of other factors are transforming how trusts are planned, drafted, and administered. How could a modern trust benefit you and your family? We would be pleased to explore that question with you. ☐

© 2021 M.A. Co. All rights reserved.

How high can stocks go?

Considerable uncertainty remains about the health of the economy in 2021. The Federal Reserve is not expected to raise interest rates until inflation returns unambiguously, for which there is not yet much indication. At her confirmation hearing for Treasury Secretary, Janet Yellen suggested that tax increases on corporations and the wealthy would likely be deferred until the economy recovers further from the pandemic.

Why then are stock market indices setting new records?

For the large-cap stocks, prices are high not only in absolute terms, but also relative to earnings. The price-to-earnings ratio is a measure of what investors are willing to pay for the future stream of earnings from a share of stock. As 2021 began, investors were willing to pay quite a lot indeed.

Yale Professor Robert Shiller popularized the cyclically adjusted price-to-earnings ratio (CAPE ratio), which smooths the earnings data over ten-year periods. The graph below plots the CAPE ratio over time with long-term interest rates. A peak of 32.56 in the CAPE ratio was reached in 1929, before the stock market crash that led to the Great Depression. The ratio stayed below 25 throughout the prosperity of the post-War period, until 1996. It rose sharply at the end of the century, spawning the term "irrational exuberance" and topping out at 44.20 in 1999. Then came the dot-com crash.

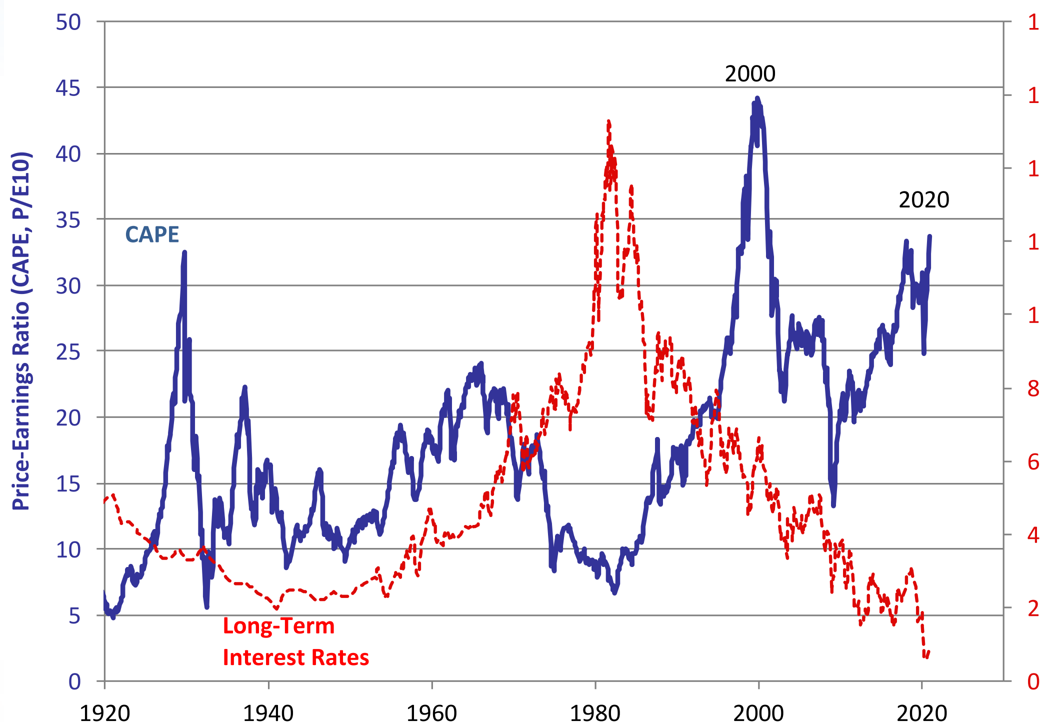
In more recent times, the ratio reached 33.31 in 2018, responding perhaps to the corporate tax reforms enacted at the close of 2017. It fell to 24.82 in 2020 during the pandemic, before recovering to 33.74 at the start of 2021.

What accounts for the surprising investor optimism?

As the graph shows, part of the answer is that low interest rates make bond investing relatively less attractive. When interest rates were very high in the 1970s, the CAPE ratio fell to low levels. Regular double-digit payouts were more enticing than the uncertainty of dividend distributions. Today's low interest rates have the opposite effect.

Another element may be a "flight to quality"—investors may believe that only the largest companies will have the resources to emerge successfully from the pandemic. Finally, investors may be looking ahead to a period when the pandemic is fully contained and the economy returns to robust growth. An increase in earnings brings down the CAPE ratio to more historically normal levels.

The answer to the headline question is that no one really knows how high stocks can go. But in uncertain times such as these, investors may benefit from professional investment counsel, such as we offer. ☐



Source: http://www.econ.yale.edu/~shiller/data.htm

Taxes on benefits

Originally Social Security benefits were treated as nontaxable income. That changed in 1983, as part of a larger plan to save the system from insolvency. On the theory that every employee had paid income taxes on his or her Social Security tax payments, but had not paid income taxes on the employer's 50% share, one-half of Social Security benefits were made includable in income. To protect the lowest-income retirees, a base amount of income was exempted from the calculation. The exemption was set at $25,000 for singles, $32,000 for married couples filing jointly, but $0 for married couples filing separately. The exemption has never been adjusted for inflation.

Taxation of benefits was revisited by the Congress in 1993. This time the theory was that in private pensions and annuities 15% of payments received may be excluded from income tax as a return of principal, leaving 85% subject to tax. Accordingly, to create a similar result for Social Security the benefit inclusion was raised to 85%, but again only for higher-income retirees. The base exclusion amount this time was $34,000 for singles, $44,000 for marrieds filing jointly, and $0 for marrieds filing separately. These figures have also never been adjusted for inflation, so that over time more and more retirees are paying income taxes on some portion of their Social Security benefits.

Patrick Kelley, a Louisiana resident, was married to Gwendolyn. Before their marriage Mr. and Mrs. Kelley executed and recorded an agreement electing, under Louisiana law, a Separate Property Matrimonial Regime. That meant that they filed their federal income taxes separately. In 2014, when he received over $20,000 in Social Security benefits, Mr. Kelley did not report any of the benefits on his Form 1040. The IRS determined that 85% of Mr. Kelley's benefits were taxable.

Mr. Kelley challenged this assessment in the Tax Court. He argued that the $0 exclusion due to his filing status was discriminatory, that it should be one-half of the amount available for joint filers, or $16,000, and that the unfairness was so extreme as to violate the Due Process clause of the Fourteenth Amendment. There was no rational basis, he believed, for making this distinction between classes of married persons.

The Tax Court was not sympathetic. Congress explained the reasoning behind the $0 exclusion thus: "If the base amount for these individuals were higher, couples who are otherwise subject to tax on their benefits and whose incomes are relatively equally divided would be able to reduce substantially the amount of benefits subject to tax by filing separate returns."

That was a rational enough reason for the Court to rule against Mr. Kelley. The distinction is not so unfair or irrational as to be unconstitutional.

Just think of it as another marriage tax penalty for Mr. and Mrs. Kelley. Had they never married, they would have together had $50,000 worth of exclusion instead of $0. ☐

Our Trust & Wealth Management Team

Keith Akre, CFA, CFP®
Vice President & Trust Officer
(815) 332-8861
keitha@stillmanbank.com

J. Joseph McCoy, JD
Trust Officer
(815) 332-8871
josephm@stillmanbank.com

Adam D. Talbert
Trust Officer
(815) 332-8865
adamt@stillmanbank.com

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

Contact us today for a no-cost,
no-obligation consultation.

Stillman
BANK

Trust & Wealth Management
8492 E. State Street • Rockford, IL 61108
815-332-8100
www.stillmanbank.com