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September 2011



Investment risks and remedies

The risks for any investment plan are very real. The remedies are professional supervision, diversification and an appropriate time horizon.

August 2011 was another roller-coaster ride for investors. Standard & Poor's downgraded the U.S. Treasury debt from AAA to AA+. Ironically, the immediate reaction in the bond market was that prices of Treasuries went up, not down. However the stock market entered into a period of severe volatility. Whether investors were more concerned about the European sovereign debt situation or the possibility of a double-dip recession here in the U.S. was uncertain, but they seemed to have a hard time deciding whether to own stocks. Four-hundred-point moves in the Dow Jones Industrial Average, up or down, became all too frequent.

There can be little question that the economy is fragile at the moment. (See "The long road back to normal" on page 2 for a visual depiction of how severe — and atypical — the downturn has been, compared with past recessions.) The usual responses of policymakers to economic

weakness don't seem to be having the expected results.

That puts investors in a bind. The Federal Reserve Board has announced that interest rates will remain at their historic low levels well into 2013. How will savers wring more income from their portfolios during the next two years? What happens if the economy does lapse again into recession, exacerbating the unemployment problem? Could asset values be at risk, as they were in 2008? What if inflation takes off? How should investors respond to these many and varied risks?

We suggest enlisting the services of professionals.

What we bring to the table

We'd like to be able to say that we have a magical solution to every investor's needs right now. We don't. No one does. And you probably already understand that.

What we do have are trust and investment services that are objective, personalized, and comprehensive.

Objective. Our investment advice reflects the same high standards that guide our work as trustee. We don't

deal in exotic financial engineering; we invest in instruments that ordinary people have heard of and can understand. To remove any chance of conflict between our organization's interests and our client's interests, we do not work on commission. Instead, we charge moderate annual fees, based on the market value of our clients' holdings. When the dollar value of a client's account grows over the years, we receive more dollars of compensation. If a client's account shrinks in value, so does our reward.

Personalized. As we see it, our business is not simply managing investment programs. Our business is helping people — helping our clients achieve their financial goals. We've learned that serious investors can't settle for a "one size fits all" approach. We see each of our clients as possessing a unique mix of financial facts, family circumstances, and personal goals. The better we understand each client's unique situation, including his or her tax picture, the better our chances of retaining the client's business for many years to come.

Comprehensive. In addition to providing our investment clients with unbiased guidance, we keep accurate records, submit detailed statements, and safeguard securities under strict audit control — all for moderate fees that can be substantially lower than the fees at some other firms.

Can we tell you more?

Would you like to know more about our services for investors? Call on us! We look forward to discussing your requirements in detail, in person. □

A capsule guide to our services for investors

Our services are, in essence, powerful financial planning tools built upon important investment management components. One of the great strengths of trust planning is the ability to tailor the plan to respond flexibly to current and future financial needs.

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 a process of disciplined 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 require-

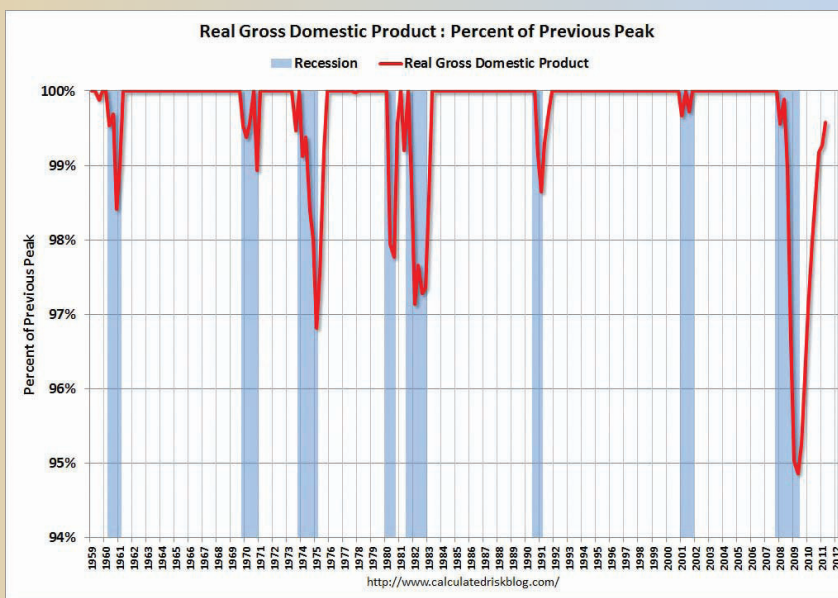
ments. We will implement that plan, providing continuous portfolio supervision and distributing or reinvesting trust income as directed. As trustee, we can move beyond the investment sphere, arranging to pay household bills and taxes on your behalf. A revocable trust provides financial protection in the event of incapacity, and it has important estate planning advantages as well.

IRA rollovers. Anyone who will receive a lump sum distribution from an employer's retirement plan would be well advised to take a careful look at an IRA rollover for the funds. A rollover preserves valuable tax privileges and can enhance your retirement capital. Taxable withdrawals may begin without penalty at age 59½, and a program of minimum withdrawals must begin at age 70½. With their tax-deferred nature, IRA rollovers present somewhat unusual investment issues, which should be resolved in the context of a full review of financial resources.

The long road back to normal

The blue bands in this graph represent the duration of past recessions. The red line shows how far gross domestic product (GDP) fell during each one, in percentage terms. GDP at the start of each recession is set equal to 100%.

As is readily apparent, the recession of 2007-2009 was the deepest in more than a generation. Although the economy has recovered from its lowest point in this cycle, we are not yet producing at the level that we were when the recession began.



Quarterly Economic Review for September 2011



Gary S. Wolfer
Senior Vice President
and Chief Economist

A Disappointing First Half

The recovery slowed in the first half as annualized real Gross Domestic Product (GDP) for the first quarter grew by only 0.4% versus 3.1% in the prior quarter. While the U.S. economy has now had seven consecutive quarters of GDP growth, the recent lack of job growth is cause for concern. For the month of June, payrolls rose by a meager 18,000 jobs, and the unemployment rate trended higher to 9.2%.

The last two employment reports indicate that job growth may have stalled following three consecutive months of solid gains averaging more than 200,000 jobs per month. Weekly jobless claims continue to be stuck in a 400,000 plus trend.

Despite the slowdown in the first half, we believe the economic recovery has not been derailed. In fact, data on personal spending and income has been consistent with a temporary pause rather than a “double dip” into recession. It’s important to remember that the intensity of the worst recession in over 80 years has caused structural damage to key components of the U.S. economy, i.e., the banking and housing segments, both of which had been the primary drivers of growth for previous economic expansions. Without such support this recovery will be characterized by relatively slow and inconsistent growth.

The Economic Outlook

Second-half GDP growth should improve; however, not to the extent that we anticipated three months ago, given the fading support from income, production and employment.

Second-quarter real GDP growth should mirror the relatively low reading for the prior quarter, resulting in first-half growth below 1%. For the second half of the year, we project GDP growth of 2.5% and 2.1% for the full year 2011. Specific factors contributing to stronger second-half performance include:

- A strong rebound in motor vehicle production.
- The recent pullback in fuel prices should help to propel spending.
- Net exports will again rise, providing an added boost to growth.
- Companies will increase capital expenditures and merger and acquisitions (M&A) in an effort to redeploy excess cash reserves.
- Corporate earnings growth should remain strong throughout the remainder of the year.

The Federal Reserve Bank— A Post-Quantitative-Easing Perspective

Core inflation continued to rise steadily in the wake of temporary supply disruptions caused by the earthquake and tsunami that struck northern Japan last March.

Despite a sharp pullback in gasoline prices, annual core inflation (as measured by the Consumer Price Index) jumped another 10 basis points to almost 1.7% — a full percentage point in just eight months. Core CPI is likely to approach 2.5% by year-end. While the Federal Reserve Bank’s (FRB) key measure of inflation remains Personal Consumption Expenditures (PCE), core PCE inflation could end the year above the 1.7% to 2.1% FRB target range. It would take a significant reversal in core inflation trends for the FRB to renew an easing of monetary policy if the “soft patch” continues into the second half. In the wake of “QE2,” the FRB is likely to remain on “standby” into 2012.

The European sovereign debt crisis has created another level of uncertainty for global financial markets. A temporary bailout package would probably be the most expedient solution in order to stymie contagion that could potentially run throughout Europe. Going forward, officials of the European Central Bank (primarily Germany and France) and the International Monetary Fund may have to act more forcefully in order to prevent a disorderly debt default. In conjunction with the markdown in the value of sovereign debt, a recapitalization of the Euro Zone banking system may also be required.

Following highly charged political debates within the House of Representatives, the U. S. Congress was finally able to reach a bipartisan agreement to raise the debt ceiling, however, the \$2.1 trillion to \$2.4 trillion in projected cuts over a 10-year period fell short of Standard & Poor’s Corporation’s (S&P) targeted requirement of \$4 trillion in cuts over the same period. In turn, S&P decided to lower the U.S. debt rating one notch, from AAA to AA+. This represented the first such downgrade in 70 years.

Bonds and Stocks

Since late April, Treasury yields declined as worries about the European debt crisis took center stage. Risk-averse investors once again sought the safety of U.S. Treasuries, causing yields to fall to historic lows. We continue to feel that investment-grade corporate bonds, high quality, dividend-paying stocks and “selective” PA municipal bonds possess more attractive total return characteristics than U.S. Treasury securities at this time. In the aftermath of quantitative easing, interest rates may remain at or near current levels for some time as European and U.S. governments try to contain abnormally high debt burdens via austerity measures. Given the changing aspects of U.S. demographics, investor demand for fixed-income securities should remain robust, causing real interest rates (net of inflation) to actually fall more than nominal rates as inflationary expectations continue to build and deflationary pressures in employment and housing slowly subside.

We estimate that second-quarter corporate earnings could grow by 15%. Strong earnings will continue into the second half of the year. On a year-to-date basis ending June 30, the total return for the S&P 500 was 6%, despite the high volatility that stock indices experienced in May and June. Strong earnings momentum and ongoing M&A activity should continue to propel equity prices higher. □

Aftermath of the year without estate taxes

There was quite a bit of press in 2010 about the billionaires whose fortunes were spared from taxes because they had the wisdom to die in the correct year, the year that the federal estate tax was suspended. The story was always a bit more complicated than that. There was a tax trade-off. Heirs would not have the benefit of the unlimited step-up in tax basis for inherited assets. That meant unrealized capital gains would be taxed upon a future sale. Limited basis step-ups were included to exempt smaller estates.

Congress waited until December 2010 to come up with the estate tax regime that applies now. The federal estate tax was restored retroactively to January 1, 2010, with a \$5 million exempt amount. Congress included a choice for the estates of 2010 decedents. They may opt out of the estate tax and into the carryover basis regime.

How does one do that? By filing Form 8939. The IRS released guidance on that Form in August.

Estates of billionaire 2010 decedents almost certainly will want to file Form 8939. Estates smaller than \$5 million may not, because they won't owe federal estate tax and will still get full basis step-ups for estate assets. The appropriate answer will be less obvious for estates larger than \$5 million but smaller than, perhaps, \$20 million or so. Evaluation by an estate planning professional will be needed. The IRS expects that 7,000 estates will be filing Form 8939. Oddly, the Service predicts that filing the Form should take the executor only 10 hours!

Absolute deadline

Form 8939 for 2010 decedents must be filed on or before November 15, 2011. If it is filed early, a Form 8939 may be amended or revoked, but only through the filing of a subsequent Form 8939 before the November 15 cutoff. There will be no extensions of time for this filing. The election becomes irrevocable on November 15. Taxpayers are not permitted to file an estate tax return plus a conditional Form 8939, to take effect only in the event that an estate tax audit results in the value of a taxable estate going above the applicable exclusion amount.

Given that the IRS took more than seven months to release the Form, allowing taxpayers just over three months for compliance may seem a bit out of balance. However, in most cases the decedent has been dead for more than a year, and the executor and tax advisors have been waiting for this development.

Relief will be available in limited circumstances for amending a timely filed Form 8939. For example, if a timely filed Form 8939 was complete, except that it failed to allocate the full \$3 million basis step-up allowed for property passing to a surviving spouse, an amended form making that allocation will be accepted. □



Jim Spindler, CFP®
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Investment Risks and Remedies

The last decade has taught investors a very important lesson about risk and reward and why you should be focused on not only the return of your portfolio, but also on the risk associated with it. There are numerous risks all investors need to be aware of. However, there are ways to position your portfolio to get an acceptable return while managing the risk of the overall portfolio.

The biggest concern most investors have is principal risk or the risk of losing money. However, investors should also be concerned with other risks including: an over-concentration of an asset class, sector or individual holding; inflation risk and the risk of outliving your money. Investors should understand what the overall asset allocation of their portfolio is and the expected return and risk associated with that allocation. When was the last time you sat down and did a comprehensive review of your portfolio to analyze the asset allocation, the diversification and the individual holdings so as to ensure you are comfortable with how the portfolio is constructed? Inflation risk is the risk that your returns may not be exceeding the inflation rate and the purchasing power of your assets is decreasing. The risk of outliving your money has become a huge concern with many retirees as health care costs, longevity and a volatile market have played havoc with many retirement plans.

Univest's Wealth Management and Trust team goes beyond professional investment management and trust services and provides the knowledge and solutions to a broad array of your financial matters. If you need to add some guidance and order to your financial life, call one of our financial advisors to help review your current financial and investment situation.



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