



SUMMER 2010

FIDUCIARY PERSPECTIVE

INSIGHTS ON PRIVATE WEALTH MANAGEMENT

Celebrating
125 years
1885-2010

A NOTE FROM OUR PRESIDENT

Last month we launched a new Fiduciary Trust advertising campaign. The ads feature either a fine timepiece, glass of wine, or guitar and compare the creation of these items to the detailed process of customizing investment portfolios for our clients. The ads will appear in regional editions of several financial magazines, on a number of investment websites, and in Boston Symphony Orchestra program books.

Advertising raises the visibility of our firm, but is not the primary source of our growth. Last year, over 90 percent of our new business came from new accounts opened by existing clients or from referrals made by clients, attorneys and accountants.

We would like to take this opportunity to thank our clients and the outside professionals who have helped us grow our business.

Doug Smith-Petersen
President & CEO

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FINANCIAL CONVERSATIONS WITH FAMILY

Although it affects many aspects of family life, money is often a difficult topic to discuss openly. Parents sometimes struggle with both how and what they should teach their children about finances.

The first thing to recognize when talking to children about money is that this topic is filled with a wide range of emotions. Over your life you have had many experiences with money, both positive and negative. These experiences color your view on the topic, and may affect your children's views as well. Your spouse may have a very different relationship with money than you do. No matter your personal experience and family dynamic, money should not be a taboo topic in family life. Although you do not want it to be the center of your family relationship, it should be acknowledged and discussed at appropriate times throughout the growth and development of your family — both before and after your children have become adults.

Teaching Responsibilities and Values

Money can be a terrific teaching tool. Providing children with a weekly allowance can be an opportunity to teach patience, self-control, delayed gratification, money management, and philanthropy. Although there is no magic age to start an allowance, many families begin somewhere between ages 7 and 11. A combination of your children's ages and the expectations you have around the uses of their allowance will often dictate the amount. Some families view an allowance as money earned for chores, such as making beds or helping with dishes, while others believe these tasks are required of children to be contributing members of the family group and do not want them tied to compensation. Either way, an allowance is a tool that can help children begin to understand the value and power of a dollar. If you want to instill that saving for the future is valuable, set a required amount or percentage that must be saved from their allowance each week. Once this amount gets large enough, help your children open an account so that they can begin to learn investment basics. You may want to fund a modest account for each of them to begin this sooner. If you want to teach the value of philanthropy, set an amount or percentage of their allowance that must be given to the charity of their choice. After setting aside amounts for savings and philanthropy, give the individual child the discretion to spend the balance. Early on they may use the money in ways that you may not agree with — such as at the candy store — but even this will help them learn that what you spend today is not available for tomorrow and that your choices today affect your ability to make choices in the future. This is a good time to set limits, and let them realize that if you spent it yesterday, you may have to go without tomorrow. As hard as this can be to watch, it is a very valuable lesson to learn.

As your children grow older, encourage them to earn their own money. Maybe they can provide childcare, mow lawns, work at a local restaurant, caddy at the golf course, work in the family

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FIDUCIARY TRUST

COMING OFF THE HIGHS

As human beings, we sorely wish for a single story or even a single number that can neatly summarize the complexity of our world into manageable pieces. So it is today. The economy would seem to be growing strongly, but there are these pesky signs of trouble. In mid-April, as the stock market rallied day after day to yearly highs, investors became complacent and even believed that the worst was over in terms of bad economic news. But that was far from the truth. The U.S. stock market reached its peak in late April and by early May we experienced the “Flash Crash” when the Dow Jones dropped 1,000 points. This was jarring but it was helpful to remind us that there are significant economic challenges in front of us and maybe the market’s complacency was ill-founded.

A Case for Nostalgia

Indeed, we believe that for this economic cycle the U.S. economy has seen its highs in terms of GDP growth rates in the fourth quarter of 2009 and the first quarter of 2010. While the economy is still strong right now, we see it slowing in the second half of the year. Job growth, which is improving now, will slow as well. These trends will force analysts to trim their growth expectations for earnings and profit margins into 2011. For the rest of 2010, it becomes problematic for the U.S. stock market to achieve the highs it saw in late April. Our industrial production growth, which drove our economy into recovery over the past twelve months, is fading and our consumer demand remains as one of the few continued bright spots in our U.S. economy.

The global economy is also slowing down. Healthy economies, such as Canada, China, Australia and India, see evidence of pricing bubbles in their markets and are wisely tapping on their monetary brakes to fight signs of growing inflation. Outside of the U.S., the U.K. and Europe have barely recovered from the past recession. Members of the European Union (EU), such as Spain, are likely to go back into recession. This makes it very difficult for such countries to service their debt. We are increasingly wary of European bank debt because of the outsized exposure to sovereign debt issues that reside on these bank balance sheets.

As the global economies slow, inflationary pressures have diminished. The price of copper, which is very sensitive to industrial demand, has dropped from close to \$3.50 a pound to under \$3.00. Oil prices have also fallen. Some of this is due to the relative strength of the U.S. dollar, as our currency and our Treasuries have been seen as a harbor of refuge relative to the euro. But it is far more telling what the other major global reserve currency, gold, has done recently. Its price, up 14% year-to-date, continues to rise relative to the dollar, showing that it is preferred as a place of safety.

Rougher Waters Ahead

As if the 1,000-point drop in the Dow Jones wasn’t sufficiently turbulent for investors, we expect further volatility coming up in the next several months. This means that we will see some strong rallies that will help punctuate the otherwise discouraging and weak stock market behavior. But the stock market will struggle to launch a prolonged challenge to April’s highs given the potential for flagging earnings growth and softer margins. In fact, as the economy descends from last winter’s altitude, it will become more susceptible to exogenous shocks and less able to withstand the buffeting of perceived and real crises.

We would not be at all surprised to see the current 10% sell-off end with a rally, but then correct again over the next few months. This has implications for portfolio construction and risk management. It also means investor expectations need to adjust accordingly to the possible continued volatility.

What about beyond the near-term outlook for the rest of 2010? What lies ahead in 2011? Are there any clues for the longer term? Our crystal ball becomes much less precise the further out we try to gaze. There is a limit to our prescience. Yet, we do agree with many of the conclusions drawn from recent work by economists Carmen Reinhart and Kenneth Rogoff that the developed world’s growing deficits will threaten the ability of our economy to grow. This is due to the higher taxes and greater regulation that typically follow a financial crisis.

The graph on the following page, created by Reinhart and Rogoff and published in their 2010 article, *Growth in a Time of Debt*, shows the track record of real GDP growth of selected advanced countries from 1790 through 2009 under different levels of debt to GDP. This shows the results of 2,317 observations during this time. The U.S. is currently at 90% debt to GDP and that ratio is growing quickly. If past is prologue, we can expect, based on history, an average U.S. GDP growth rate of between 1.5% and 2.0% at our high level of debt. This means unemployment rates will not come down quickly over the next several years. Inflation potentially may be elevated due to central banks inflating their economies out from under the debt burden. Under such a weak expected GDP growth rate, the economy will not be as resilient and may be more prone to slipping into recessions.

How long may this toxic mix of anemic growth and inflation continue? Niall Ferguson, in his talk to the CFA Annual Conference in Boston this spring, reported that for those economies fortunate to have central banks, such as the U.K. and the U.S., inflation is historically the most acceptable way to

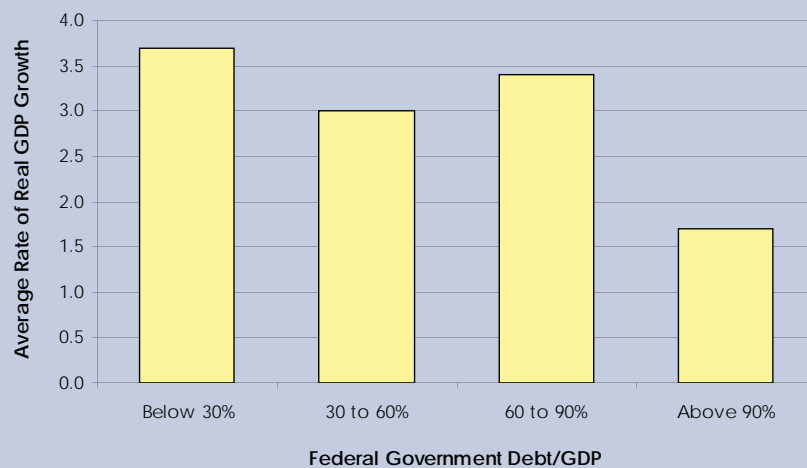


NEWS AND NOTES

manage the huge impending deficits and debt. These countries, the U.K. especially, suffered stubborn inflation rates for ten-plus years after World War II. The benefit of reducing war-related debt is that there is an armistice day, after which war-related financing goes away. There is no peace-time equivalent. The debt burden just keeps growing, with no endpoint in sight.

Other countries not as fortunate to control their own central banks, such as the member states of the EU, will more likely default on their sovereign debt. Neither outcome is attractive. They differ only by matter of degree.

Real GDP Growth as the Level of Government Debt Varies: Selected Advanced Economies 1790 - 2009



Source: Reinhart and Rogoff (2010)

An Evolving Paradigm

We actively challenge ourselves as we think of how best to address such a difficult investment world. There is little room for complacency. The old approaches of buying and holding just a few stocks and a laddered bond portfolio of U.S. assets seem inadequate to address what lies ahead. Yet, there may be a place for some of these strategies in an overall portfolio of diverse solutions. Going global remains attractive, even if European banks represent a potential difficulty for financial markets. The emerging markets and perhaps even the frontier markets in Africa may present the best opportunities for growth. The use of defensive hedge funds and commodities, including gold, will help to reduce and control the volatility of the future portfolio. We continue to apply our best thinking to search for attractively priced asset classes. It is important for clients to realize that the investment world of the next 5 years may continue to disappoint in terms of matching returns of even a few years ago. Our goal is to preserve capital as well as grow assets in these troubling times. ■

○ | **Stacy Mullaney Addresses ABA Conference**

In May Fiduciary Trust attorney Stacy Mullaney spoke at the Annual Symposia of the American Bar Association Section of Real Property, Trust & Estate Law. Trust, estate and real property attorneys from across the country gathered in Philadelphia to discuss the latest legislative, judicial and regulatory developments. Stacy presented on the topic of Complex Securities Laws and the Eligibility of Trusts to Make Alternative Investments.

○ | **Mike Mullaney Appears on Bloomberg TV**

Also in May, Mike Mullaney was interviewed by Bloomberg Television about European debt levels and their impact on broader fixed income and equity markets. Mike, who has appeared on this financial network several times, is the chair of Fiduciary Trust's Fixed Income Committee and a member of the Investment Committee.

○ | **Private View™ Enhancements Completed**

In June we launched an improved version of our online client tool, Private View™, with expanded graphics, enhanced security, and compatibility with a broader array of browsers and operating systems. All current users were sent secure emails with new passwords. If you have questions about the new Private View™ or about signing up for this service, please contact your investment officer.

○ | **Roth IRA Conversions**

As featured in the Fall 2009 issue of *Perspective*, income limits have been removed, allowing anyone to convert a traditional IRA to a Roth IRA. If you would like a reprint of the article, please see the Publications and Announcements section of our website (fiduciary-trust.com) or speak with your investment officer.

business or even start their own business. It is still reasonable to require your children to save a percentage of what they earn and to give some amount to charity from their earnings.

Another way to teach values and responsibility with respect to money is to get your children involved with your family's charitable giving. If you have a family foundation, involve your children with both charity selection and discussions about how the foundation's assets are invested. Even if you do not have a foundation, having your children involved in charity selection can be a great way to teach them about researching charitable entities and to provide an opportunity for discussions around money and the value of giving. If you have more than one child, consider allowing them to collectively select a charitable beneficiary to receive some amount of funding. By asking them to explain the reasons for their choice, you can be assured that they have worked collaboratively and that conversations about money are becoming part of their relationship.

Your Beneficiaries

Children often learn from the behavior of their parents, and the handling of money is no exception. Despite concerns about anticipated inheritances ruining a child's drive or ambition, most families recognize that it is important to deepen their discussions around family wealth as children mature. It is true that a relatively small amount of wealth can sound like a lot to young adults, but if you have been talking to them openly about finances over time, they will be more likely to realize that the \$100,000 you may have saved for them is not enough to create a life of leisure. If you expect your children to be educated and obtain gainful employment, they should know this. If you expect your children to be stewards of the family's wealth, and possibly even add to it, then they should know that also.

If your family has significant family assets, it may be important to discuss the idea of premarital agreements with your children. The best time to introduce this concept is when children are young adults, and definitely long before their fiancés enter the scene. Bringing this up early and without a particular person in mind can help take some of the emotion out of what can easily become an emotionally charged discussion. You should realize, however, that a premarital agreement will require some disclosure about the assets your child will likely inherit. This makes it important that you continue to talk to your children about your family's wealth as they become more responsible.

Your Legacy

Despite detailed planning and well drafted documents, many estate plans are ineffective because the next generation is not adequately prepared to receive and become stewards of the family's wealth. Just like a CEO would never turn over the reins of a business to someone who had no idea what the business does, parents should not plan to turn over the family wealth to children who do not understand it. The depth and frequency of family discussions may vary with the level of wealth, but the discussions need to occur regardless. You should not wait until you can clearly envision your passing to begin to prepare your children for what may (or may not) be coming their way.

Parents sometimes struggle with whether they should leave assets for a particular child's benefit in trust or give it to them outright. Often, trusts are desirable because future circumstances are unknown while the desire to keep the family wealth for the benefit of descendants is clear. Properly drafted, trusts can be flexible and can easily adapt to future circumstances. Having honest discussions with your children about your reasons for utilizing trusts can help them understand the many protections afforded by trusts while helping to ensure that your values and legacy benefit future generations.

One way to prepare children is to have all of you meet with trusted family advisors. Meetings like this usually evolve over time, with initial meetings being carefully planned with your input as to what information is presented. Discussions about asset allocation can be a terrific way to educate the next generation. Estate planning vehicles can be discussed without numbers until it is appropriate to make more detailed financial disclosures. As time passes and everyone gets more comfortable with the topics involved, more significant information can be shared and your expectations can be communicated.

Conclusion

As a parent, you can have a significant impact on your children's relationship with money. Responsible financial choices by you and open conversations with your children are important in making sure that money is not a taboo topic. Family discussions about money will help ensure that wealth can be successfully passed onto future generations, preserving your family legacy. As always, your Fiduciary Trust account officer is available to discuss these topics. ■

By Jody R. King, CPA, JD, RLP®, Vice President