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Market Commentary – December 10, 2008

RegentAtlantic is a fee-only wealth management firm. We define wealth management as the integration of financial planning and investment management. Our clients are individuals, retirement plans, foundations, corporations, trusts, not-for-profits and endowments. We manage approximately \$1.2 billion of assets. Our clients outline their goals and are guided by our knowledge and solutions in order to meet those goals. Some differentiators for our firm include:

- We have a deep bench of financial professionals. Among our 38 employees, we have 16 CERTIFIED FINANCIAL PLANNERS™, 5 Chartered Financial Analysts, 10 MBAs, 2 CPAs, 2 JDs, 2 with MS degrees, 1 ChFC, 1 CDFP, and 1 CLU. Our culture fosters teamwork and collaboration, so that each client of the firm has access to the expertise of any and all of our financial colleagues.
- When we begin a relationship with a client, we first seek an understanding of that client's goals and financial situation. For individuals or families, examples of those goals can be retirement, planning for education funding for our client's children, charitable giving, estate planning, or buying a second home at the shore. From the information provided, we analyze with our client what steps will likely be necessary to achieve our client's financial goals, and when appropriate, what tradeoffs our client may have to consider to achieve those goals. These steps help us to recommend a diversified investment portfolio for our clients to consider.
- Our firm's investment discipline is based upon the principles of Modern Portfolio Theory. We use globally diversified, multi-asset class portfolios which we believe, over the long term, have the potential to increase return while limiting the risk taken to achieve that return. Of course, as recent events have shown, all investments have risk, including the risk of loss of money invested.

To give you a sense of our relationship with our clients, we recently sent the Market Commentary below to clients on December 10, 2008.

If this communication arrives at a time when you are evaluating your financial future, we would welcome the opportunity to talk with you.

This is a two-part communication about the need to re-visit existing estate planning strategies, and about the activity that most of our clients have been and/or will be seeing within their portfolios.

Estate Planning

For many clients, this is a highly appropriate time to sit down with their estate planning lawyer and see whether changes are needed to avoid future disappointments, or whether this is a time to take advantage of new opportunities to avoid future taxes. In brief:

- The division of one's estate among the beneficiaries under existing documents may lead to a result quite different from what was intended, either because of changed asset values or because of the increased federal exemption (or both).
- Existing life insurance policies may – or may not – be appropriate to achieve one's goals.
- Lower asset values, combined with lower interest rates, now offer unusually effective lifetime gifting opportunities.

With a married couple, a primary question is whether, when the first spouse dies, all of that spouse's assets should be given to the other spouse, using some combination of an outright gift and gifts to marital and bypass trusts. Alternatively, some of the deceased spouse's assets could be given directly to children, grandchildren, or other beneficiaries. That is especially common if the first spouse to die leaves children from a prior marriage, but it might also make sense when there was no question of the surviving spouse's security and some of the children or grandchildren could clearly use some help. In some cases, the existing estate plan provides that, when the first spouse dies, that spouse will leave directly to children and/or grandchildren an amount equal to the federal estate tax exemption. Given the portfolio losses and the increase of the federal exemption to \$3.5 million, it may be important to revisit such decisions and provide that the surviving spouse will receive some minimum amount of wealth before any gifts were made to other family members.

At the 50,000-foot level, planning for large estates starts by asking how one's wealth should ideally be divided among family, charity, and the government, the tradeoff being that you can give less to the government by giving more to charity. Sound answers developed in the past may not make sense if one's total estate is 25% or 30% smaller today and there's now a \$3.5 million federal exemption. Where the division of the estate between family and charity was framed in terms of percentages, you might want to change that to specify that the family would receive the first \$XXXXXX of the estate, with only the excess shared with charity. This can be especially important with IRAs and other "retirement assets", which have often been prime candidates to fund charitable gifts in order to avoid the income tax shrinkage incurred when such assets are left to family members. It may no longer make sense to give any of one's retirement assets to charity until the overall gifts to family have reached a certain level. This is an easy problem to overlook, given that many people pay much less attention to their retirement asset beneficiary designations than to their wills and trust agreements.

Families where the engine of wealth has been a closely-held business often pose special challenges when not all members of the next generation have signed up to continue in that business. A client will often have designed some kind of balancing act, passing the business to the child(ren) who will continue it while maintaining "fairness" to the other child(ren) by giving them other assets. At this point, the balance in value between the business and those other assets may have been seriously altered.

Many people have funded significant life insurance coverage to help offset the anticipated burden of death taxes. Those death taxes may no longer seem so onerous now with a \$3.5 million federal exemption and a smaller portfolio, and one may feel less able to afford the on-going premiums. At the same time, one may feel that the insurance, instead of being needed for taxes, will now help to assure the beneficiaries' well-being despite the portfolio losses, at least until one has lived long enough for the portfolio to recover. This may be the perfect time to obtain a careful audit of all of one's existing policies by a qualified insurance advisor. Aside from questions as to amount and type of insurance coverage, it is always important to verify that the ownership and beneficiary designation of each policy is consistent with one's overall estate plan.

The 2001 tax act has now provided more than enough humor over the spectacle of our great nation's repealing its federal estate for one year in 2010 and then reinstating it in 2011 with the \$1 million exemption and 55% marginal rate that prevailed in 2000. That humor is now all but officially behind us; there seems to be near unanimity in Washington that estate tax repeal won't happen in 2010 or at any other time in the foreseeable future. It remains unclear whether the \$3.5 exemption taking effect next month will become permanent, with or without an inflation adjustment, and whether the current 45% rate will also be made permanent. Amendments to existing tax laws are a certainty with the new Administration and Congress; one can only guess how the balance will be struck between the need for economic stimulus and Obama's pledge of tax reforms.

In all events, it appears we will be living with a federal estate tax for a long time. We are also likely to continue living with a system where many states, including New Jersey, will continue to count on death taxes to support their budgets. Those clients who – despite the financial meltdown – remain confident about their own long-term security and who want to maximize what they leave to family and charity, while minimizing their gifts to the government, need to maintain their focus on shrinking their ultimate taxable estates.

One's taxable estate can be shrunk at death by outright or split-interest gifts to charity, and by packaging one's wealth in vehicles such as family partnerships or limited liability companies that may achieve valuation discounts. If one can afford it, however, it is usually far more effective to shrink one's taxable estate by making gifts while one is alive.

For example, one can give up to \$12,000 per year (or \$13,000 as of next month) to as many individuals as one likes with no effect on the \$3.5 million exemption at one's death. Direct payments of beneficiaries' medical and tuition expenses are totally excluded. There are no such \$13,000 or medical/tuition exclusions at death.

Further, all growth on a gifted asset between the date of the gift and one's death occurs outside one's estate. When financial markets suffer the kind of nosedive we're enduring, history suggests that it has become more likely that the markets will experience robust growth in the future. Giving cash to one's beneficiaries now will allow them to invest in financial assets at unusually distressed prices.

Aside from cash gifts, this is also a great opportunity to shift ownership of interests in securities, real estate, and closely-held businesses, all of which are probably valued much more modestly than 12 months ago. In the case of split-interest gifting vehicles such as grantor retained annuity trusts and charitable lead annuity trusts, one has the double benefit of both low market values and a low IRS hurdle rate; the

“section 7520 rate” that a GRAT or CLAT has to beat to be successful is now 3.4%. (With existing GRATs that are unlikely to shift any wealth, given the market meltdown, it may be possible to swap their assets into new GRATs with a much higher probability of success.) Although a qualified personal residence trust works better with a high section 7520 rate, that will be more than offset in many cases by today’s reduced appraised value for the home. Where the assets that could be gifted still involve a lot of unrealized appreciation, so that the gift would be shifting an ultimate capital gains tax burden to the beneficiaries, it may be worth considering an installment sale of the assets, leaving the donor with the capital gains tax and giving the beneficiaries a new, higher basis. The donor could then make subsequent gifts of cash to help the beneficiaries cover the installment note payments.

Some people might be tempted to think that, with a \$3.5 million federal exemption (which means \$7.0 million for a married couple), they don’t need to worry about their beneficiaries facing death taxes. In fact, however, an estate under \$3.5 or \$7.0 million may still face significant taxes depending upon which state one manages to die in. New Jersey’s exemption was frozen at \$675,000 in 2001 (\$1.35 million for a couple), and there’s no sign it will be increased anytime soon. People who aren’t relocating to Florida or another zero-death-tax state shouldn’t focus exclusively on the federal exemption.

One final point, and then we’ll promise to avoid mentioning estate planning at least until next year. There has been some speculation about possible 2009 tax legislation that would retroactively repeal certain estate planning strategies, such as GRATs and valuation discounts for interests in family-controlled entities. This could be the last month to implement certain techniques, and if such legislation is retroactive, there will be no way to know for sure until it’s too late to do anything different. So we repeat: Anyone concerned about implementing lifetime gifting strategies should be speaking with his or her lawyer as soon as possible in order to minimize the risk of serious regrets in the future.

Recent and Current Portfolio Activity

Most clients have been receiving a number of trade confirmations over the past several weeks and will continue to do so over the next two weeks. Given the extraordinary bear market we have experienced this year, it is especially important to manage portfolios as tax-effectively as possible. While we don’t expect our clients to get even slightly excited about harvesting their losses, we believe it’s important to grab these losses now, both to offset gains that may have been realized earlier this year and to use against gains in future years. By using a number of exchange-traded funds, we can maintain similar exposures to the Global Large Cap, U.S. Small Cap, International Small Cap, Emerging Markets, and Real Estate asset classes that are currently held in client portfolios. After selling existing positions to book the losses and holding the substitute ETFs for a period of at least 31 days to avoid the “wash sale rule”, we will look to migrate from the ETFs back to our recommended funds.

In addition to harvesting tax losses, by swapping into these ETFs in December we are trying to shelter taxable accounts from capital gain distributions being made by a number of our recommended mutual funds. While not all distributions may be avoided, we are trying to minimize the insult added to injury by taxable distributions from funds that have suffered significant price declines.

For clients who hold individual large cap stocks, we have been actively re-optimizing these strategies. Our optimizations take into account many factors including valuation metrics, earnings quality metrics, tax loss harvesting (in taxable accounts), and overall risk constraints tied to the S&P 500. The market

volatility we have seen recently has led to significant shifts in our stock rankings. We continue to believe that the indiscriminate selling of stocks by so many entities as well as individuals has created significant gaps between current prices and inherent values. By increasing our turnover for the individual stock optimizations, we are able to shift to stocks that are ranked higher as well as accomplish significant tax loss harvesting.

We encourage any clients with questions about these portfolio activities to give us a call.

Conclusion

The suspense about the fate of the “Detroit Three” should end soon. With Senator Shelby still talking about a filibuster, President-Elect Obama encouraging the bailout from a safe distance, and an initial \$15 billion plan now being voted on in the House (as this went to press), we should see more of the political and market drama we’ve become used to in the past three months.

We continue to enjoy working with our clients and deploying their portfolios as well as we know how, while helping them address all the other financial aspects of their lives in conjunction with their other advisors. Despite the deep discontent in many parts of the world that explodes in the terrorism just seen in Mumbai, we remain cautiously optimistic about our collective future. We thank you for your trust, and look forward to continuing to earn it.

Sincerely,

RegentAtlantic Capital, LLC

Important Disclosure:

RegentAtlantic Capital does not provide legal, tax, or accounting advice; this email reflects our own understanding of current tax law. To the extent that a reader has any questions regarding the applicability of any specific issue discussed above to his/her individual situation, he/she is encouraged to consult with the professional advisor of his/her choosing. Please remember that past performance may not be indicative of future results. Different types of investments involve varying degrees of risk, and there can be no assurance that the future performance of any specific investment, investment strategy, or product made reference to directly or indirectly in this letter will be profitable, equal any corresponding indicated historical performance levels, or be suitable for your portfolio. Due to various factors, including changing market conditions, the content may no longer be reflective of current opinions or positions. Moreover, you should not assume that any discussion or information contained in this letter serves as the receipt of, or as a substitute for, personalized investment advice from RegentAtlantic Capital, LLC. To the extent that a reader has any questions regarding the applicability of any specific issue discussed above to their individual situation, they are encouraged to consult with the professional advisor of his/her choosing.

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