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Dynamic Adaptation

How Will You Cope In Rapidly Changing Times?

by Mike Palmer, CFP®

If one thing is sure, we humans are a highly adaptive and dynamic species. The evolution of the internet offers a great example of how we adapt and change. No matter one's degree of "tech savviness" there is no denying dynamic adaptation is critical in business as well as in other walks of life.

A friend of mine recently was in the market to replace his aging minivan. Using the web he was able to discern a competitive price for his vehicle and placed it for sale on Craigslist.com, an on-line "community" that offers as one of its main attractions no charge classified ads. It is, very simply, an electronic flea market. Within two days he'd sold his van. For his replacement vehicle he turned to the web again, getting information on-line to determine dealer pricing for the features and options he wanted and then enlisting the AAA motor club car buying service which secured his new van at a competitive price and even delivered it to his door. "I spent less than two hours on both transactions combined and believe I got fair deals on both," he said. "I'll do it the same way again the next time I'm in the market for a car."

What is clear from this example is that the free market forces adaptation and that the internet is changing the course of everyday life. Five years ago my friend would have likely sold his car through a classified ad in the local paper. Craigslist is changing the competitive landscape and declining "old media" profitability reflects it. Car dealerships are also facing dramatic change. The sale of cars has become more akin to the sale of a razor, a very low



NOTABLE QUOTE

"Character is like a tree and reputation like its shadow. The shadow is what we think of it; the tree is the real thing."

Abe Lincoln

The Trust Company of the South is a fee-only independent trust company and financial planning firm focused on serving the needs of affluent individuals, families, and non-profit institutions.

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Beneficial New IRA Rules

by John Slayton, JD, LL.M.-TAX, CFP®

IRA's are the ultimate portable pension. Between annual contributions and rollovers between jobs and at retirement, IRA balances will continue to balloon in future years, as baby boomers retire and roll their large pensions into personal IRAs. Last year's Pension Protection Act contained a number of new IRA rules designed to make them more user friendly.

- >> **IRA contribution limits will be indexed for inflation starting in 2009** – Limits are \$4,000 in 2007, \$5,000 in 2008, with a \$1,000 catch-up for people over 50. In 2009, IRA contributions will be indexed for inflation, but not catch-up contributions.
- >> **Direct rollovers from retirement plans to Roth IRAs** – Starting 1/1/2008 rollovers can be made directly from retirement plans to Roth IRAs, providing the client meets the requirements for converting to a Roth IRA. AGI must be under \$100,000 (excluding the amount converted) and income recognized on the conversion must be reported in the year and amount converted.
- >> **Special Roth IRA conversions in 2010** – Traditional IRAs can be converted to Roth IRAs in 2010 without the \$100,000 AGI limitation. Income taxes payable on Roth conversions during 2010 are deferred until 2011 and 2012. *This presents interesting planning possibilities that we will discuss in future issues.*
- >> **Rollovers by non-spouse beneficiaries of certain retirement plan distributions** – Effective 1/1/2007, non-spouse beneficiaries of a decedent's IRA may roll-over qualified retirement plan distributions to an inherited traditional IRA. Distributions must be made via direct trustee-to-trustee transfer and the IRA must be established as an inherited IRA, with appropriate minimum distributions taken over the lifetime of the beneficiary. This benefit was previously limited to spousal roll-overs.
- >> **Tax-free distributions of IRAs to charities** – Effective for tax years 2006 and 2007 only (although Congress is currently debating making it permanent), "qualified charitable distributions" of up to \$100,000 may be made from IRAs and Roth IRAs *directly to qualified* charities by individuals age 70 1/2 and over. It is not necessary for the client to itemize deductions, but the distribution must have otherwise been tax deductible (without regard to the percentage limitations that generally apply). Because no income is recognized on the distribution, no deduction is allowed. This will facilitate charitable contributions for donors who were previously limited in their contributions for numerous reasons.
- >> **Direct payment of tax refunds to IRAs** – Effective 1/1/2007, all or a portion of tax refunds may be sent directly to IRAs.

IRA planning has become more complex over the years. As the vehicle of choice to receive accumulated pension assets to draw upon during retirement, effective use of IRAs is crucial.



US Court of Appeals Strikes Down Merrill Lynch Rule

by Mike Palmer, CFP®

On May 30, the US Court of Appeals ruled in favor of the Financial Planning Association and against the Securities and Exchange Commission in a lawsuit challenging the SEC's ruling providing brokerage firms an exemption to the Securities Act of 1940.

This is a huge win for investors. The SEC's exemption had allowed brokerage firms to masquerade as investment advisors by providing fee-based accounts without accepting the increased liability of a fiduciary as required of registered investment advisory firms or trust companies.

Prior to the ruling brokerage firms had offered advisory services with a disclosure on account statements akin to the FDA "warning label" on cigarettes. The disclosure reads:

"Your account is a brokerage account and not an advisory account. Our interests may not always be the same as yours. Please ask us questions to make sure you understand your rights and our obligations to you, including the extent of our obligations to disclose conflicts of interest and to act in your best interest. We are paid both by you and, sometimes, by people who compensate us based on what you buy. Therefore, our profits and our salespersons' compensation may vary by product and over time."

Increasingly consumers are becoming better informed and more educated on the differences between an advisory serving in a fiduciary capacity and one serving in a broker suitability capacity. For more information on how to find a fiduciary investment advisor visit www.focusonfiduciary.com.

Interestingly, a survey by the Zero Alpha Group and the Consumer Federation of America released last month found that 90% of consumers believe that the same investor protection rules should apply to stockbrokers and investment advisors.

FOOD FOR
THOUGHT

Investment Strategies

One of the most prevalent issues that we at Trust Company manage for our clients deals with the allocation of proceeds from stock concentration liquidations. Typically, we will allocate those proceeds into a well-diversified portfolio that provides market risk reduction accompanied with income and growth for the future. The big question that inevitably comes up: **Do we allocate all at once or do we maintain a cash position and then dollar cost average in over time?**

Noted financial author Nick Murray recently addressed this very issue in his April 2007 newsletter, *Nick Murray Interactive*, that we believe to be a frank and thoughtful response to this issue:

"For the record, this question – in all its numberless variations – is not about dollar-cost averaging. It is about holding cash which is to be invested in equities for the long run out of the market for any reason whatsoever. The answer is that doing this is not prudent; it is reckless. It is not merely market timing, it is market timing against odds of about four to one the other way."

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Behind the Scenes at Trust Company of the South

- >> John Slayton, Mike Palmer and Bill Noble recently presented a series of financial planning seminars to the University Health Systems of Eastern Carolina's Brody School of Medicine.
- >> John Slayton recently joined the Greensboro Estate Planning Council.
- >> Bill Noble recently completed a peer group review with Ritter Daniher Financial Advisory, LLC, a fee-only advisory firm in Cincinnati, Ohio.
- >> Brad Sutton is serving on the finance committee of his church, Mount Pleasant UMC, Greensboro.

INVESTMENT STRATEGIES, *cont'd*

"The equity market in the U.S. rises, on average, a hair under four years out of five. Unless you admit that you are consciously timing the market, forecasting a meaningful decline while you are dollar-cost averaging – and if this is your position, you should be shot – the odds against your achieving a lower total cost by dollar-cost averaging are therefore four to one against. (Or, if you prefer, the odds of getting a better outcome investing the lump sum by nightfall are four to one in your favor.)"

"Absent conscious market timing, therefore, gradual investing of a lump sum only appears "prudent" if you are without any knowledge of the equity market and of the economy which it reflects. Those of us who dollar-cost average do so not because we want to but because we have to: we are accumulating wealth out of current income, and are therefore investing over time because we realize our income over time. If and when one has the luxury of a lump sum to invest in equities for the long run (which is, or ought to be, a redundancy), it is to be invested instantaneously using market orders."



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DYNAMIC ADAPTATION, *cont'd*

margin commodity business, with the more attractive profit stream coming from service, i.e. the sale of razor blades.

As investors, it is important to understand and recognize change. Many investors have a slavish attachment to stocks that have been "in the family" for generations. These "heirloom stocks" have often been engines of wealth for 10, 20 or even 30 years. But as is often the case, companies rarely stay great forever. One need only look at the turnover in the composition of the Dow Jones Industrial Average over the last 40 years to see how the pace of change is accelerating.

Between 1960 and 1980, the Dow saw only three changes in its composition – 3M, IBM and Merck replaced Anaconda Copper, Chrysler and Esmark respectively. Between 1980 and 2000 the Dow saw 16 changes in its composition. In less than two generations over half the Dow companies turned over, and nearly 1 in 6 ceased to exist altogether.

Economist Joseph Schumpeter coined the phrase "creative destruction" to describe the process of industrial transformation that accompanies radical innovation. It is quite clear that the internet is a radical innovation in the early stages of transforming our lives and will continue to do so in ways we haven't yet imagined. We believe owners of heirloom stocks would be wise to keep this in perspective.