[the*compass*] spring 2012

THIS ISSUE...

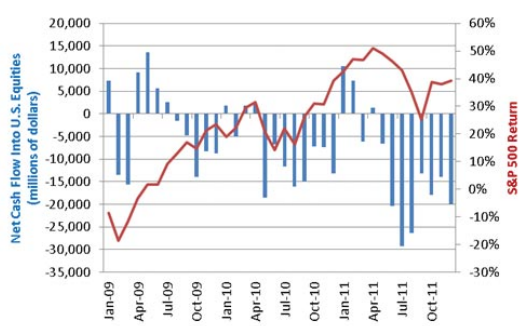
The Flight of the Lemmings

by Mike Palmer, CFP®

As I write it is four years and one day removed from the collapse of investment bank Bear Stearns, which many believe was the promontory from which the great mortgage deleveraging and the corresponding Great Recession flowed. The S&P 500 closed at 1276 on March 17, 2008 and one year later almost to the day, March 9, 2009, the S&P had bottomed at 676.

Along the way, droves of investors fled the stock market. And there the vast majority stayed…in money market funds…paying less than 1%.

According to the Investment Company Institute, from September 2008 through the end of 2011, net flows out of equity mutual funds totaled an astounding $325 billion. As noted financial columnist Nick Murray is fond of saying, they don't ring a bell at the bottom. The average investor has done the wrong thing with astonishing consistency. The net outflows from equities continued for the first quarter of this year, even as the S&P started the year with a jump of 11%. An article in *SmartMoney* magazine tallied the loss of profits by investors, through their collective untimely exits from the market over the last five years, at a staggering $100 billion.



The portfolios of a whole generation of investors will struggle to recover from this self-inflicted wound. Happily, for our clients, this roller coaster ride was largely a non-event, and not because we were able to forecast market tops or bottoms. Our clients are well-schooled in the discipline required of long-term investors. They embrace the difference between temporary decline and permanent loss. They realize and accept that the historical *average* equity return of 8% comes at the expense of those investors unable or unwilling to stomach the most vicious volatility, who panic and sell out when things look bleakest.

This cycle, much like history, will undoubtedly repeat itself. Woody Allen's quip about success (80% is just showing up) applies equally to investing. A significant ingredient is simply showing up and being in the market at all times.

NOTABLE QUOTE

"Our country's businesses will continue to efficiently deliver goods and services wanted by our citizens. Metaphorically, these commercial "cows" will live for centuries and give ever great quantities of "milk" (dividends) to boot." - Warren Buffett, in his 2011 Berkshire Hathaway shareholder letter.

Trust Company of the South...because wealth management is more than managing money

Taxes in Transition

by John Slayton, CFP®

"THE HARDEST THING IN THE WORLD TO UNDERSTAND IS THE INCOME TAX." – ALBERT EINSTEIN

Springtime brings blooming flowers and trees, pollen and tax season. Last time we discussed beneficial estate and gift tax tactics for today's high exemption, low interest rate and property value environment. Today we will turn to a perennial favorite… income taxes. This year presents a unique situation with numerous tax rates, credits and deductions already expired or expiring at year end 2012. The riskiest approach in this uncertain environment is to freeze and do nothing until things clarify in 2013. Advance planning remains the best tax approach, hopefully alleviating, if not eliminating, detrimental financial results regardless of what happens to the tax laws. Please consider the following:

GONE, BUT NOT FORGOTTEN…

- THE ALTERNATIVE MINIMUM TAX ("AMT") PATCH expired at the end of 2011. The AMT is indexed for inflation after 2011 and the number of taxpayers affected by the AMT will jump from 4 million in 2011 to 30 million in 2012 (unless Congress changes things). We have discussed many times the misguided results of the AMT, originally adopted to catch a few deep pocket taxpayers who had avoided paying any income taxes, and now affecting tens of millions of middle income taxpayers. The AMT is not likely to be repealed any time soon, as that would likely blow any budget apart.
- CHARITABLE CONTRIBUTION OF IRA ASSETS, a useful way to transfer Required Minimum Distributions ("RMDs") directly to charities without taking them into income, ended in 2011.
- STATE SALES TAX DEDUCTION, rather than state income tax, for states without an income tax, is gone.
- HOME ENERGY TAX CREDIT is gone.

GOING, GOING, GONE AS OF YEAR-END…

- PAYROLL TAX CUT OF TWO PERCENTAGE POINTS – back to 6.2%.
- TOP INCOME TAX RATE OF 35% – back to 39.6%.
- LONG TERM CAPITAL GAINS TAX RATE OF 15% – back to 20%.
- QUALIFIED DIVIDENDS 15% TAX RATE – back to ordinary income rates, up to 39.6%.

NEW FRIENDS/ RETURNING ACQUAINTANCES

- MEDICARE SURCHARGE ON NET INVESTMENT INCOME – married couples making over $250,000, whether from wages or otherwise, will pay an additional 3.8% Medicare tax on passive net investment income.
- MEDICARE SURCHARGE ON HIGH INCOME TAXPAYERS – the same group will be paying an additional 0.9% in Medicare tax.
- PERSONAL EXEMPTION AND DEDUCTION PHASEOUT – the same group will see a return of the personal exemption phaseout rules, removing the exemptions for joint incomes from $250,000 to around $372,000 and removing up to 80% of deductions ratably for joint incomes over $250,000.

Continued on back cover

Non-Profit Spotlight: Elon Academy

by William H. Smith, CFP®

As an Elon University Trustee from Alamance County, I'm proud to feature the Elon Academy. Established in the summer of 2007, the mission of the Elon Academy is to provide academically oriented, low-income high school students in Alamance County with the support they need to attain a college education. Many of these young men and women fail to recognize their own potential. Lacking role models with a background of higher education, they are pessimistic about their chances for attending a four-year college or university.

The Academy includes three consecutive summer residential experiences prior to the sophomore, junior and senior years, as well as year-round Saturday programs for students and families.

A few statistical highlights:

- Academy graduates have been accepted at almost 60 colleges & universities
- 98% of graduates are enrolled in college
- 100% of scholars are enrolled in honors and AP classes at their high schools
- 100% of Academy scholars have engaged in community service

If you would like to support this effort or would like more information, please contact Deborah Long at 336.278.5859.

Day of Discovery Symposium

Tuesday, May 1

Carolina Country Club
2500 Glenwood Avenue
Raleigh, NC
8am to 12pm

Join Trust Company for a morning of discovery and discussion.

8am to 9am – **Breakfast**

9am to 12pm – **Sessions**

- Larry Wheeler, director, North Carolina Museum of Art
- Buying or Selling a Business? – Panel Discussion with Dennis Dougherty of Intersouth Partners, Larry Robbins of Wyrick Robbins Yates & Ponton LLP, and Charles Shook of Trestle Capital Partners LLC
- Zemo Trevathan, Co-Author *Daring to Have Real Conversations in Business*

Seating is limited. Please contact Lisa Shirley at lshirley@tcts.com or 919-781-8287 to secure a reservation.

Behind the Scenes at Trust Company of the South

>> Gardner Noble, son of **Bill Noble,** was recently inducted into the National Honor Society at Rocky Mount High School. He will attend UNC next year.

>> A special thank you to Lou Pucillo, Jack Murdock and Charlie Bryant who joined us on March 1 for our initial book luncheon.

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"THE AVOIDANCE OF TAXES IS THE ONLY INTELLECTUAL PURSUIT THAT CARRIES ANY REWARD." – JOHN MAYNARD KEYNES

With the prospect of all of these new taxes, what should we be focused on now, in order to limit pain next year?

- First of all, Congress could act to ameliorate some of the scheduled lapses, increases and new arrivals. Election year machinations will likely limit the scope of tax legislation, however. Congress could always just vote to continue things as they are today for another year or more, kicking the can (and the tough decisions) down the road. This could be delayed until a lame duck session of Congress after the election, however, not leaving a great deal of time for careful planning and execution.
- Given the scheduled increase in long term capital gains tax from 15% to 20%, we might reverse our typical approach of delaying recognizing capital gains, accelerating them into 2012.
- Similarly, if we have a sizable long term capital gain recognition event, such as a sale of a business, we might consider accelerating it into 2012 or closing it under an installment sale approach, in order to avoid the 3.8% Medicare surcharge on net investment income starting in 2013.
- Remember that if you converted assets from a traditional IRA to a Roth IRA in 2010 and deferred the income tax bite, you have to recognize one-half of the taxable amount on each of your 2011 and 2012 tax returns.

Finally, do not forget that the merged estate/gift tax exemption is scheduled to decrease from $5 to $1 million next year. We may never see a more asset transfer favorable environment than today. Congress may act to delay this decrease or increase the exemption above the 2001 level of $1 million, but, given budgetary constraints, it is not likely to be as high as $5 million going forward.

"THE POINT TO REMEMBER IS WHAT THE GOVERNMENT GIVES IT MUST FIRST TAKE AWAY." – JOHN S. COLEMAN

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