THE TRUST COMPANY OF THE SOUTH

The Compass

WINTER 2004

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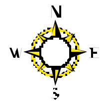

Do You Have A Five Year Health Plan?

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

800.800.9440

Thank you to our clients (and referring professionals) for allowing us the privilege of serving your wealth management needs. 2003 was the most successful year in the history of our firm. We appreciate your confidence and trust.

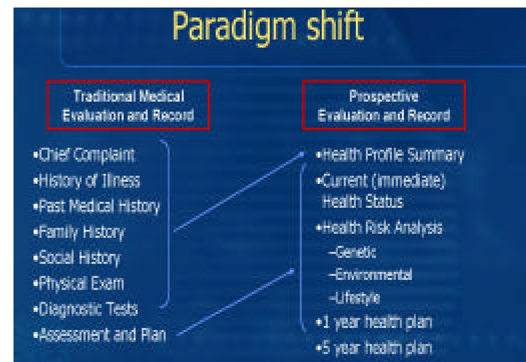
Most successful businesses have a business plan, often projected out 3-5 years. Some people prepare a business plan for their personal financial affairs. But how many people have a personal health plan—one that extends beyond diet and exercise?

That question was posed by Dr. Ralph Snyderman, CEO of Duke University Health Systems, at the InterSouth Partners annual meeting last month. Dr. Snyderman's keynote address was particularly interesting since my own family is struggling with the issue of end-of-life care for my aging grandmother.

Dr. Snyderman believes we are on the cusp of a revolutionary change in medicine akin to the changes of the early 20th century's when the discovery of viruses and vaccines, along with the shift from an agrarian society to an industrial one, increased the average American life expectancy from 48 years in 1900 to 75 years in 1995. It is entirely likely that advancements in human genome research will enable current Baby Boomers to routinely live to age 90 and beyond.

These health care advances impact us in a variety of ways:

- the ethical dilemmas associated with end-of-life, quality of life, and privacy of health care information
- the societal question of what level of health care to insure for all our citizens
- the political quandary of a Social Security system originally intended to support retirees for years, not decades
- the investment impact all of the above issues will have on pharmaceutical and health insurance companies

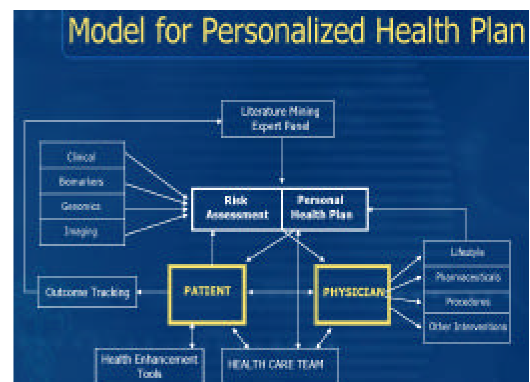


Genetic testing is readily available today for many cancers, diabetes, and Alzheimer's disease. Discovery of a genetic predisposition may allow for earlier treatment, perhaps delaying the onset of chronic disease. Many health insurance companies now cover the cost of genetic testing.

One's personal health plan will take shape much earlier in life and will combine personal risk assessments with a personal health plan. The goal will be to engage disease (or susceptibility thereto) in the earlier stages, perhaps when the symptoms are barely perceptible and the treatment less expensive. It is estimated the treatment of chronic disease accounts for 75% of health care expenditures or nearly $1 trillion annually.

So as the permanence of New Year's resolutions begin to abate, rethink your commitment to your new personal health plan.

- Mike Palmer, CFP®



The Pursuit of Wealth Management

It seems that everyone from insurance companies to local banks are touting their "wealth management" capabilities. Heck, before you know it, Wal-Mart will probably get in the game. A lot of this is "puffery" on the part of commission salesmen trying to ditch the product pusher image. I get a chuckle out of how financial service providers try to "position" themselves with titles, slogans, and the like. Stockbrokers are now "financial consultants" – no doubt a friendlier sounding title and presumably one less likely to be viewed as "selling" product.

Several relatively new firms in the Triangle are running large ads in the business section of the *N&O* touting their *Wealth Management for the Triangle.* But how exactly do these firms define *wealth management?*

An examination of the firm's ADV (a form all registered investment advisers are required to file with the SEC and available for review on the SEC advisor website www.adviserinfo.sec.gov) indicates that the firm does not engage in financial planning services. So exactly how does one "manage wealth" without performing financial planning? Financial planning is the thread that weaves together the assorted pieces of one's financial security blanket.

I'm constantly amazed at the oversights committed by other financial advisors who lack a comprehensive financial planning perspective. For example, we recently met with a new client with a $10 million net worth, but all brokerage accounts were in joint tenancy with right of survivorship. This oversight by the broker rendered the client's estate plan virtually useless. I wish I could say this was a singular occurrence, but it happens with frightening regularity.

At Trust Company, we believe *wealth management* is more than a marketing slogan. It requires professional expertise, fiduciary focus, and an unwavering commitment to protecting our clients interests. Our wealth management philosophy combined with a fee-only compensation structure and an objective investment model provide a unique contrast to traditional brokerage relationships.

2004 Predictions

Suze Orman is on her way to becoming the Martha Stewart of personal finance. And like the Duchess of Decor, Ms. Orman may learn that crossing the Rubicon from "professional" to "celebrity" has risks. I have no doubt the pay is better, but I'm always skeptical of someone who leverages professional success to become a one person marketing juggernaut. At some point the practice of one's profession begins to suffer from the increasing demands of self-promotion.

So it is with Ms. Orman. Like Paris Hilton to a Klieg light, Suze can be found espousing her financial freedom mantra on CNBC, Oprah, and QVC (for $23.96, of course). While I'm all for financial advice for the masses, I'm sufficiently jaded to doubt one's ability to diagnose financial problems in two minute segments. Remember, Suze, – there is such a thing as too much exposure – just ask Martha or Paris.

We haven't seen the last of the mutual fund scandals. With late trading and market timing making headlines in '03 we think Mr. Spitzer (and others with job security concerns calibrated to November) will continue to bang the drum for reform. This could be both good and bad for investors. **The good is likely to take the form of limits on or elimination of 12b-1 fees.** These "marketing and distribution" fees have long overstayed their welcome. Several firms (AIM, Putnam, and ING, to name a few) are even audacious enough to charge 12b-1 fees as high as 1% on funds that are closed to new investors!

The bad may come in the form of more regulation. Mr. Spitzer trumpeted the $600 million settlement reached with Alliance Capital in mid-December. The settlement involved a $250 million fine and $350 million in reduced fees by Alliance over the next five years. But we would respectfully argue, to paraphrase the former campaign slogan of Spitzer's fellow Empire State colleague, *"It's the transparency, stupid!"*

The focus shouldn't be on *what* the fees are— that's for the markets to decide - but on making fees *easily discernable.* Straightforward disclosure of fund expenses and fund manager compensation would be a much better remedy than taking money away today, only to have it subjected to the same system of obfuscation, concealment, and deceit tomorrow. Mutual fund executives with interests aligned with shareholders are as scarce as politicians of modest ambition (as rumored gubernatorial candidate Spitzer surely knows). I'm sure the management of Alliance and other mutual fund miscreants can't wait for their "penalty" to run its course so the pillaging and plundering can begin anew.

- Mike Palmer, CFP®

Investment Commentary

For investors, the years from 1999 to 2003 amounted to a severe test, and for many it was an excruciatingly painful experience. The truth is that in our investment lives, just as in the rest of our lives, we are always being tested. We are tested on the clarity of our investment philosophy and process, on our intellectual honesty with respect to our belief in our process, and we are continuously tested on our ability to stay disciplined and resist the many temptations that can pull us away from our philosophy and circle of competency. These temptations include pursuing hot investment trends simply because they are hot, investing based on gut feel, or cutting corners on our research while hoping those corners won't really matter. ***It is this steady hand on the rudder that differentiates a true financial advisor from a financial facilitator.***

Last year may have been the final chapter to the bubble run-up and collapse of the 1990s. Just as the most fervent bull-market revelers tend to experience the greatest suffering when the music stops, those that latch on to doomsday scenarios fail to recognize that bad times end too. In the worst case, former bubble investors retreated to cash and missed the market rebound after participating in the worst bear market since the 1930s. We have a very high degree of confidence in our investment process, which combines analysis of underlying economic values, risk assessment, and discipline. We're grateful for last year's success but we're also aware that we have and will again at times make mistakes. Our portfolios will not beat the benchmarks in every year. But we are very confident in our ability to continue to deliver good, long-term performance through the disciplined execution of our investment process.

For our clients who didn't let pessimism get the best of them, 2003 was a hugely rewarding year, with all equity-type assets delivering very high returns. Last year our WINTER 2003 edition of *The Compass* outlined our belief that, despite the prevailing doom and gloom, we believed the stock market was considerably undervalued. Our assessment proved to be correct.

In looking forward, what has and hasn't changed from a year ago?

- Cyclical, macroeconomic risks have declined.
- The economy is in recovery and gaining strength.
- Deflation risk is much reduced.
- The uncertainty of an impending war is gone.
- Terrorism risk continues to be impossible to predict.
- Investors are again investing in equities.
- The dollar moved sharply lower against the euro.
- Interest rates are likely to move somewhat higher.

Our focus is to assess whether there are clearly undervalued asset classes that provide a margin of safety. Unfortunately, based on our analysis, all equity-type asset classes are in a fair-value range.

At this time of year it's common for people in our business to make a return forecast for the year. We don't profess to have any extraordinary insight into the short-term direction of the market. One-year return forecasts are speculative at best, since investor psychology and unpredictable short-term events can drive returns, rather than long-term fundamentals. We are much more comfortable assessing the potential for returns over longer time periods. Our expectations are driven by our valuation assessments. With most equity asset classes around fair value, returns over five years and longer are likely to fall in the 5-7% range. As we outlined in the last issue of *The Compass* bonds are likely to deliver less than their yield, which is to say they will probably deliver returns below 4%-5%.

Our assessment of some other asset classes is as follows:

- **REITs**: They're probably 15-25% overvalued after returning 35.7% in 2003. We reduced our weighting in late fall.
- **Global Bonds:** Our concern about the declining dollar led us to research foreign bonds as a possible hedge against a dollar collapse. Global bonds offer "free insurance" against a dollar collapse, since we believe it is likely (though not a certainty) that the dollar will continue to gradually weaken for some time and since yields on foreign bonds are currently slightly higher than on domestic bonds.
- **International Equities:** We continue to view international equity as a critical asset class in all diversified portfolios. The weakening dollar and economic growth overseas are favorable trends for international equity. Our passive international manager delivered 66% last year for International Small Cap and 36% for International Large Cap.

We continue to believe full asset class diversification is critical to long-term success. Reliance on one fund or investment style (a one-trick investment pony) is likely to lead to disappointing investment results.

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Quote of the Quarter

"The deception is that the broker seems to give objective advice. In fact, he is paid more for pushing only certain funds."
- Tamar Frankel, Boston University law professor on brokerage firm "preferred" mutual fund vendor practices.

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TRUST COMPANY OF THE SOUTH

RALEIGH OFFICE

Michael H. Palmer, II CFP® Principal
919.781.8287 mpalmer@tcts.com

BURLINGTON OFFICE

John H. Slayton, JD Principal
336.538.1000 jslayton@tcts.com
William H. Smith, CFP® Principal
336.538.1001 wsmith@tcts.com
David D. Butler Principal
336.538.1002 dbutler@tcts.com
Shannon F. Bradsher Principal
336.538.1003 sbradsher@tcts.com

ROCKY MOUNT OFFICE

William H. Noble Principal
252.451.8728 bnoble@tcts.com

The Trust Company of the South
3105 Glenwood Ave Suite 102
Raleigh, NC 27612