

THE EDUCATED INVESTOR

Fall 2000

Maintaining Your Balance

A great investment plan doesn't have to overshadow the rest of your life. In fact, you can build a high-quality portfolio ... *and* have time left to enjoy it. Particularly when your investment advisor helps you implement these three main steps to achieving balance:

1. Building your portfolio via asset allocation
2. Maintaining your portfolio by rebalancing
3. Enjoying your portfolio

Step One: Build It

Some time ago, financial economists determined that the vast majority of a portfolio's returns are determined by the asset allocation decision. The most important investment decision your investment advisor can help you make, therefore, is choosing how assets are allocated within your equity investments (domestic vs. international, growth vs. value, and small vs. large) and within your fixed income (taxable vs. municipal, short-term vs. long term, investment grade vs. non-investment grade). What allocations are right for you are determined by three criteria:

- ▲ Your willingness to take risk (risk tolerance)
- ▲ Your ability to take risk (investment horizon)
- ▲ Your need to take risk (financial goals)

Step Two: Rebalance It

Once your investment allocations have been implemented and time passes, the value of each asset class within your portfolio is likely to change by a different percentage. This performance variance will impact the amount of risk in the portfolio by creating what is called "style drift." When your investment advisor helps you rebalance — restoring your portfolio to its original asset allocations and risk profile — he or she is implementing an integral step to a winning investment strategy.

Rebalancing causes you to "buy low and sell high" by selling your recent outperforming (or overweight) asset classes and purchasing recent underperforming (or underweight) asset classes. However, rebalancing is complicated by resulting transaction costs and, if you're working with your taxable account, by capital gains taxes. The transactions costs

and taxes are created when you sell the recently outperforming/overweight asset classes that have unrealized gains. The benefits of rebalancing typically far outweigh the costs, but it makes sense to minimize costs as much as possible. Your investment advisor adheres to the following guidelines when helping you rebalance:

- ▲ Avoid rebalancing when extremely minor style drift has occurred; it is important to differentiate between minor market jitters and what is likely a legitimate need to rebalance.
- ▲ Use new assets when available to purchase underweighted holdings, rather than selling current overweighted holdings to do so. In other words, if you have new cash available, it creates the perfect opportunity to

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Trusting in the Future

In our last issue of *The Educated Investor*, we focused on a special type of charitable trust, the charitable gift account. In this issue, let's take a step back to look at the bigger picture of trusts in general. An important tool for transferring wealth to your heirs, trusts can eliminate probate; help you make gifts to individuals or charities; and perhaps most importantly, reduce, eliminate or defer estate taxes.

As a general rule of thumb under current laws, if your total taxable estate is more than \$675,000 in year 2000, you might be a good candidate for a trust or trusts to shelter part or all of your estate from estate taxes. Using trusts such as Irrevocable Life Insurance Trusts, Charitable Remainder or Lead Trusts, or Generation Skipping Trusts can remove a good portion or all of your assets from your estate and your heirs' estates, thus minimizing, deferring or avoiding estate taxes.

Your investment advisor is an important part of the estate-planning process, along with your attorney and your CPA. Working together, they can help identify assets that

should be placed in your trust, recommend the appropriate types of trust(s) and draft the trust document that designates your advisor as the investment manager of the trust, so that your assets can continue to be managed in accordance with your wishes throughout the trust's existence.

Once you and your team have determined what types of trusts are appropriate for you, a trustee needs to be selected. The trustee oversees the investment manager to ensure the trust is being invested in accordance with its provisions and provides all the trust account administration and record keeping. **Santa Fe Trust** is one example of an independent corporate trustee that can fulfill this role or can work in a co-trustee capacity with family members or with your investment advisor.

Selecting a corporate trustee or co-trustee such as Santa Fe Trust can be of great benefit to you and your heirs. The role of trustee requires many complicated and time-consuming administrative responsibilities. If these responsibilities are left solely to a family member, it can lead to conflicts, unnecessary expense and poor investment performance; under extreme cases, it can even lead to litigation. An independent corporate trustee can relieve or reduce this burden.

Further, because Santa Fe Trust is an *independent* trustee, your investment advisor remains as the trust's investment manager throughout its existence. Such a relationship helps ensure that the portfolio you have so carefully constructed remains intact, to pass on to your heirs according to your wishes and as you have planned all along with your trusted investment advisor. This may not be the case if you designate a *full-service* trustee such as a bank trust department or trust company. A full-service trustee can and often does take over as your trust's investment manager after you die or become incapacitated; your trust can be assigned to an individual who may never even have met you.

In short, serving as an independent trust company enables a firm such as Santa Fe Trust to concentrate solely on quality trust oversight service, leaving your investment advisor to provide continuity when implementing your investment decisions — for you and your heirs.

Contact your Investment Advisor if you would like to learn more about services available from independent trust companies such as Santa Fe Trust.



Popular magazines and Web sites often offer pop quizzes that let you test your acumen on a wide range of topics, ranging from real estate to romance. Following are questions we've seen regarding stock market investing. See for yourself how you fare:

1. Which investment has offered the best long-term protection against inflation?
 - a. Bonds
 - b. Govt. National Mortgage Association Securities (GNMAs)
 - c. Money market funds/bank accounts
 - d. Stocks

2. From 1926 to 1999, the return on US stocks has averaged how much per year?

a. 5 percent	b. 11 percent
c. 19 percent	d. 28 percent

3. Common stocks always provide higher returns than bonds or money market investments.

a. True	b. False
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4. If your portfolio initially contains only US stocks, will you reduce or increase your overall risk if you add international stocks?

a. Reduce risk	b. Increase risk
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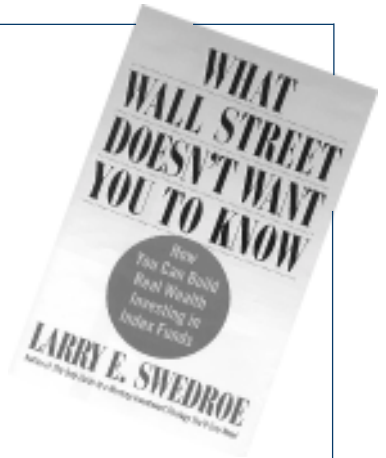
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Investor Tester Instant Answer

For Your Reading Pleasure ...

Coming soon to a bookstore or Web vendor near you, we are pleased to announce the publication of ...

What Wall Street Doesn't Want You To Know

by Larry E. Swedroe



Continuing in the tradition of his first best-seller *The Only Guide to a Winning Investment Strategy You'll Ever Need*, Swedroe's second book combines an easy-to-read and entertaining format with the latest solid data and supporting materials. The book guides the reader past all of the Wall Street hype and into the world of passive asset class investing.

John Bogle, founder and former chairman of The Vanguard Group, comments, "This wonderfully iconoclastic book drums home the message that beating the stock market is a loser's game. Larry Swedroe's new book tilts — successfully — at the windmills of professional managers, Wall Street analysts, owning "the best 100 companies" (or the best ten funds), hedge funds, market timers, investment newsletters, and short-term strategies. Once you're convinced by the powerful case the author has made, he then offers seven steps to playing a winner's game."

Published by St. Martin's Press, the book is scheduled to be available for purchase beginning December, 2000.

Worth Repeating
Worth Repeating

// Whenever you think you've found the key to the market,
some SOB changes the lock. //

— G. M. Loeb

Maintaining Your Balance (cont.)

rebalance. This approach reduces transactions costs and capital gains incurred when selling current holdings to rebalance.

- ▲ Rebalance where possible inside tax-deferred account(s).
- ▲ Avoid reinvesting distributions or adding contributions in overweighted asset classes; reinvest or contribute instead in an underweighted asset class. Likewise, take necessary withdrawals from overweighted asset classes.
- ▲ Avoid selling appreciated holdings until you have held them for 12 months or longer, to obtain lower capital-gain rates.
- ▲ When selling shares in mutual funds, sell shares with the highest cost basis first by using the specific identification method.
- ▲ When realizing taxable gains to rebalance, consider harvesting losses to offset the gains. At the same time, your advisor ensures you remain invested in alternative vehicles within the same asset class during the period you are harvesting the loss (observing what is known

as the 31-day wash-sale rule). Your advisor can add value even further by actively seeking opportunities to harvest losses in your taxable accounts, even when rebalancing is not needed.

- ▲ When faced with realizing capital gains to rebalance, consider limiting your rebalancing plans. In other words, rather than fully rebalancing to your original allocation, your investment advisor may advise you to rebalance within more flexible, predetermined tolerances. For example, if your large-cap growth asset should be 15 percent of your portfolio and it has grown to 19.5 percent, your advisor might suggest you rebalance to 17 percent, incurring fewer taxes while remaining close to your target.

Step Three: Enjoy It

Actually, this is the one step where you and your family must go it alone. But we trust you'll have your own thoughts on how to enjoy your savings! Initial asset allocation and ongoing, disciplined rebalancing is an important part of the winning investment strategy. Like maintaining a good friendship, your investment advisor's regular maintenance of your portfolio can pay off in the long run with many long-term benefits.



Instant Answer (from page 3)

1. The long-term outperformer is (d) Stocks.
2. In fact, for more than seven decades, US stocks have returned on average (b) 11 percent per year.
3. However, because it is (b) False that stocks *always* provide higher returns (and in fact can underperform for several years at a time), all but the most intrepid investors typically buffer their risk by investing at least a portion of their portfolio in fixed income.
4. The beauty of diversification is that the sum of the parts can be greater than the whole. You can actually (a) Reduce risk by diversifying into international markets. This is despite the fact that many international investments (particularly emerging markets) are actually considered individually more "risky."

Our Basic Tenets

Our objective is to design portfolios using passive asset class funds that maximize investors' returns within their tolerance for risk. Here is what sets us apart:

- ▲ Fee-only investment management
- ▲ A disciplined investment strategy
- ▲ Access to institutional no-load passive asset class funds

- ▲ An academic Nobel Prize-winning investment approach
- ▲ Continued access to academic research
- ▲ A tax-efficient focus, with valuable tax and estate-planning ideas
- ▲ Risk tolerance assessment
- ▲ Periodic portfolio rebalancing
- ▲ Regular communications and state-of-the-art reporting
- ▲ MOST IMPORTANT ...
A TRUSTED ADVISOR RELATIONSHIP