Waller Financial Planning Group

Winter2016

LegacyPress

LIFESTYLE & LEGACY CHOICES BY DESIGN℠

Fact

With the recent enactment of the Protecting Americans from Tax hikes Act of 2015, IRA Charitable Rollover has been permanently extended.

Source: Waller Financial

> *When clients work with us they think of us more as family rather than just being their advisor and it goes both ways for us.*

Charles Kerwood, III
CFP®, ChFC®, AEP®

Fact

Page 1:
Why You Need To Rebalance Your Portfolio
Jason Farris, CFP®, CAP®

Page 2:
How To Eliminate Biases In Your Investment Process
Jason Eliason, CFP®, ChFC®, CFA®

Page 3:
Charitable Lead Trusts: An Overlooked Gift & Estate Tool
Charles Kerwood, III, CFP®, ChFC®, AEP®

Page 4:
News & Notes

Why You Need To Rebalance Your Portfolio

By: Jason Farris, CFP®, CAP®

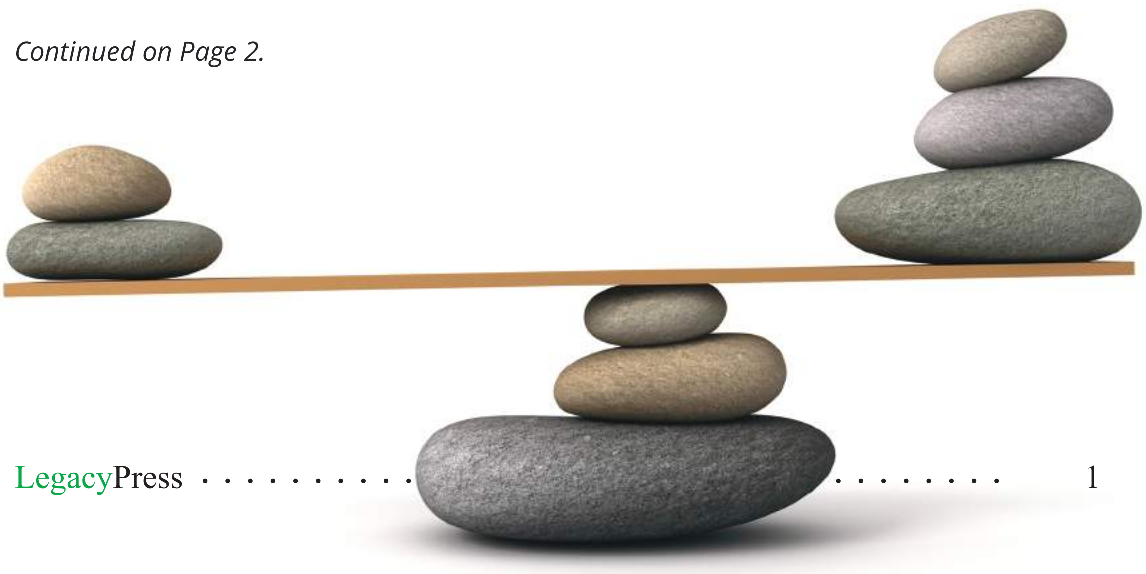
In a recent meeting a client asked, *"How do you rebalance my portfolio?"*

When discussing investment portfolios, most of the focus tends to be on **asset allocation**, security selection and market performance; however, rebalancing your portfolio is quite important, because it maintains fundamental integrity. Having a portfolio rebalancing strategy provides protection, so it will not deviate more than a pre-determined amount from the targeted asset allocation. This is important because the asset allocation of your portfolio provides an understanding of the amount of risk within the portfolio, as well as an expected rate of return.

Your asset allocation model is designed to match your cash flow needs, time horizon and aversion to risk. We design the asset allocation model to provide the highest potential return with the least amount of risk necessary in order to meet your goals. Given the importance of determining the right asset allocation model, a strategy is necessary to make sure that this model stays within an acceptable range of that original targeted asset allocation. That is where portfolio rebalancing comes into play.

Due to market forces, portfolios will deviate over time from the expected risk-return profile of the asset allocation model. Generally, portfolios become more risky if they are never rebalanced, simply because higher-return assets tend to have significantly higher risks. By not rebalancing your portfolio, an initially diversified portfolio will become less diversified over time.

Continued on Page 2.



Why You Need To Rebalance Your Portfolio (Continued)

We utilize a rebalancing process based on deviation from targets. This is also referred to as a **threshold rebalancing strategy, or a tolerance band rebalancing strategy.** After the asset allocation model is constructed, we then set an allowable tolerance to deviate from the targeted allocations to each asset class. For instance, an allocation model may have a 15 percent allocation to an asset class, such as large cap U.S. stocks with a 5 percent tolerance. That means the asset class will not be reallocated back to 15 percent unless it is at more than 20 percent, or less than 10 percent.

In addition to rebalancing portfolios via deviation from targets, we also utilize the inflows and outflows of portfolios to rebalance. For example, if a portfolio is out of alignment from the targeted allocation, but within the acceptable tolerance bands, it would not be rebalanced; however, in this scenario when a portfolio deposit or withdrawal occurs, we use this change to bring the portfolio into better alignment with the target allocation.

A disciplined process of rebalancing a portfolio is essential. It helps ensure a portfolio remains invested with the same amount of risk as originally intended. It also allows us to rely on a strategic process for making investment decisions instead of emotionally reacting to what is currently happening in the market.

How To Eliminate Biases In Your Investment Process

By: Jason Eliason, ChFC®, CFP®, CFA®

Biases are inherent in all of us, and virtually in everything we do. At Waller Financial, we have scrutinized our investment process to eliminate biases whenever possible. I do not believe all biases can be eliminated all the time; however, our process aims to identify them, so we can acknowledge the biases and proceed appropriately. We strive to build our opinion on the merits of an investment not our biases.

We start by having a clearly defined investment philosophy: *Preserve and increase the real wealth of clients through a disciplined process that focuses on goals, risk aversions and cash flow needs.* One of the most important aspects of our investment philosophy is that it is a disciplined process.

One of the most common biases we try to eliminate is **anchoring.** Since we have used many of our money managers for years, we can easily anchor our current opinion based on our historical assessment of our money managers. In order to combat this, we remove the manager's name when reviewing investment results. This allows the raw numbers to speak and not an ingrained opinion.

Another common bias in the investment world is **framing,** which is defined as being influenced by how something is presented to you. It is very common for companies to interview money managers during their due diligence process. We do this as well; however, we place the interview last, whereas most firms do it early in the process. We do this to form an opinion of the merits of an investment before talking with the money managers. Our objective is to eliminate the money manager from influencing our process.

Confirmation bias is another common bias we strive to eliminate in our investment process. **Confirmation bias** is when you consciously or subconsciously seek out information to confirm your initial assessment while ignoring a contrasting view. To combat this, we draft a contrarian opinion on every decision we make. Before proceeding with an investment, we ensure the contrarian viewpoint has been properly assessed.

Hindsight bias is unique and challenging because it can affect us in a number of different ways. It is rather easy for our brain to remember things differently then how they actually happened. This bias can occur when decisions turn out good or bad. The important aspect of removing hindsight bias is to focus on the process, not the outcome. You can have a great process that results in an undesirable outcome, just as you could have a bad process that resulted in a good outcome. Over time, however, a good process will be rewarded.

Loss aversion is another bias, but we embrace it rather than eliminate it. Like you, we strongly prefer to avoid losses more than making gains. In our process, we focus on reviewing investment results on a risk-adjusted basis than just a gross return. Additionally, when reviewing investment performance, we favor investments that are more consistent versus volatile.

Having a disciplined process that reduces or eliminates biases is essential for achieving long-term investment results.

Charitable Lead Trusts: An Overlooked Gift & Estate Tool

By: Charles Kerwood, III, CFP®, ChFC®, AEP®

As a financial planner, it is important to be familiar with various tools that help our clients develop appropriate strategies to meet their lifestyle and legacy goals. Most people are familiar with donating cash or household items, or even gifting highly appreciated securities to their favorite charities. Some people may even be familiar with the benefits of creating a charitable remainder trust, but many are unfamiliar with the frequently overlooked tool, the **charitable lead trust (CLT).**

A charitable lead trust is oftentimes described as being the reverse of a **charitable remainder trust** – instead of the donor receiving income during their lifetime (or a term of years) with the remaining corpus gifted to charity at the donor's death, the CLT provides income to a charity for a specified number of years, with the remaining assets given back to the donor or the donor's heirs. Although there are multiple variations of the CLT, this article will focus on one type, the **non-grantor lead annuity trust.**

A typical client considering this type of CLT might have the following characteristics:

- Have investable assets of $5,000,000 or more
- Are currently making significant contributions to a charity
- Own assets that are expected to substantially increase in value
- Do not need income from the assets being used to fund the gift
- Desire to lower the value of their estate to minimize future transfer taxes

Interest rates play a very important role in this type of planning tool. When interest rates are very low there is a larger upfront interest to charity. The assumed interest rate that is used when calculating the upfront interest to charity (and thus the remainder interest to heirs) is published by the IRS and is called the **Section 7520 rate.** As of Jan. 2016, the Section 7520 rate is 2.20 percent.

Here's an example: Mildred has substantial real estate holdings that she feels will increase significantly during her lifetime. She has been very successful, and would like these properties to be given to her nieces and nephews upon her passing. She is also charitably inclined and concerned about estate taxes. Mildred creates a non-grantor lead annuity trust with the following characteristics:

- $2,000,000 funding amount
- Trust term of 20 years
- Annuity payout rate of 5 percent
- Section 7520 rate of 2 percent

Based upon this fact pattern, Mildred's favorite charity will receive an annual payment of $100,000 ($2,000,000 times the 5 percent annuity rate). The present value of this payout, using the Section 7520 discount rate is $1,635,140. This implies a remainder interest to the nieces and nephews of $364,860 ($2,000,000 less the $1,635,140 given to charity). If the assets increase by more than 2 percent per year during the 20 year term, the excess growth will be transferred with no gift or estate tax ramifications.

Although this article has not covered many other variations of the CLT, you can see by our simple illustration that this planning tool is useful in providing benefits to both a favorite charity and heirs of the grantor.

News and Notes

2015 Tax Information

2015 has come and gone quickly, and now it's time to start compiling documents, records and IRS Forms in preparation of filing your income tax returns. In order to assist you during this process, we outlined LPL's 2016 mailing schedule for 2015 tax information. All of the information below may not be applicable to your situation.

Retirement Accounts

- If you distributed money from a retirement account during 2015, you will receive Form 1099-R.
- Form 1099-R will be mailed on **February 1, 2016.**

Taxable Investment Accounts

- If you owned a Non-retirement account during 2015, you will receive a Consolidated 1099.
- Consolidated 1099 includes the following IRS Tax Forms; 1099-DIV, 1099-INT, 1099-B, 1099-MISC and 1099-OID.
- Consolidated 1099s will begin mailing on **February 1, 2016** on a staggered mailing schedule and continue through **March 15, 2016.**

Waller Financial Planning Group

941 Chatham Lane
Suite 212
Columbus, Ohio 43221
614.457.7026
www.waller.com