The
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DAY & ENNIS, LLC
FEE-ONLY FINANCIAL PLANNING

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An Example Of The Power Of Diversified Portfolios

When it comes to investing your hard-earned dollars, the recipe you use can be more important than the ingredients you use. In other words, how you allocate your funds into different asset classes can have a bigger impact on your returns over time than what you put into your portfolio.

That's why portfolio experts stress the importance of diversification, asset allocation, and periodic rebalancing, rather than touting the latest "can't miss" stock buy. However, due to the fact that hot stock tips often seem more interesting than diversification strategy, many investors continue to play the market-timing game rather than maintain a solid long-term strategy.

In a recent presentation on bond performance, Craig L. Israelsen, an associate professor of finance at Brigham Young University, provided a clear and convincing example of the power of asset allocation to improve returns over time. He compares the performance of portfolios with one asset, two assets, and four assets from 1948 through 2012 to show that portfolio diversification trumps securities or fund selection.

The accompanying chart, "Bond Performance in a Portfolio Context," analyzes returns from three different portfolio mixes under conditions of rising interest rates and declining interest rates. The analysis shows that market performance doesn't affect returns nearly as much as diversification of a portfolio.

The 34-year period from the start of 1948 through 1981 was a time of rising interest rates, and U.S. bonds averaged an annualized return of 3.83%. During that period, the Standard & Poor's 500 stock index averaged 11% annual gains while U.S. Treasury bills averaged 4.49%.

The 31-year period from 1982 through 2012 was a time of declining interest rates, during which U.S. bonds averaged an 8.82% gain annually, the S&P 500 averaged 11.14%, and U.S. Treasury bills averaged 4.72%.

So the background to this portfolio comparison is the fact that U.S. bonds clearly performed much better during the latter period. Because analysts expect interest rates to rise during the next few years, it may be reasonable to conclude that bond returns likely will fall. "The question is how much does (this) matter in terms of building an overall portfolio," Israelsen

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Bond Performance in a Portfolio Context

Portfolio	Period of Rising Interest Rates 34-Year Period from 1948 to 1981	Period of Declining Interest Rates 31-Year Period from 1982 to 2012
1-Asset Portfolio 100% US Bonds	3.83% Annualized Return 4.32% Standard Deviation	8.82% Annualized Return 6.99% Standard Deviation
2-Asset Portfolio 60% Large US Stock 40% Bonds	8.52% Annualized Return 10.49% Standard Deviation	10.56% Annualized Return 11.33% Standard Deviation
4-Asset Portfolio 40% Large US stock 20% Small US Stock 30% Bonds 10% Cash	9.52% Annualized Return 11.80% Standard Deviation	9.99% Annualized Return 10.98% Standard Deviation

Craig Israelsen, Brigham Young University

Matt Heller, CFP, Joins Day & Ennis

We would like to introduce a new member of our team, Matt Heller. Matt is a CERTIFIED FINANCIAL PLANNER™, having attained the certification issued by the Certified Financial Planner Board of Standards. He has extensive experience in financial planning for healthcare professionals, working as the lead financial planner for a company serving the Medical Center of Central Georgia and the Upson Regional Medical Center. Matt received his MBA and BS from Georgia Southern University and completed the Executive Financial Planner Program through the Terry College of Business at the University of Georgia. He is married to the former Jennifer Stone of Macon. Matt's background in financial planning makes him a good fit for Day & Ennis. His expertise will be a welcome addition as our firm continues to grow.

Sincerely,
Day & Ennis, LLC

Roundup Of New Estate Tax Changes

For more than a decade, estate planning has harkened back to the "wild, wild west," a time when even the best hired guns didn't know what would happen next. Now, finally, there's more certainty, thanks to the estate tax provisions in the American Taxpayer Relief Act (ATRA). The new law, signed as the country teetered on the brink of the "fiscal cliff," extends several favorable tax breaks, with a few modifications.

Before we explore ATRA's main provisions, let's recap the events dating back to 2001, the year the Economic Growth and Tax Relief Reconciliation Act (EGTRRA) was enacted. Among the changes, EGTRRA gradually increased the federal estate tax exemption from $1 million to $3.5 million in 2009 while decreasing the top estate tax rate from 55% to 45%. It also severed the unified estate and gift tax systems, creating a lifetime gift exemption of $1 million unrelated to the estate tax exemption. Then the law repealed the estate tax completely, but just for 2010. After that year, the estate tax provisions were scheduled to "sunset," restoring more onerous rules that had been in effect before EGTRRA, unless new legislation dictated otherwise.

The Tax Relief Act of 2010 generally postponed the sunset for two years. It hiked the estate tax exemption to $5 million (indexed for inflation), lowered the top estate tax rate to 35%, and reunified the estate and gift tax systems. That law also allowed "portability" of exemptions between spouses.

Now, at long last, ATRA brings permanent clarity. Here are the key estate changes:

- The estate tax exemption remains at $5 million with inflation indexing. For 2013, the exemption is $5.25 million. Also, portability of exemptions between spouses is made permanent, so a married couple can effectively pass up to $10.5 million tax-free to their children or other non-spouse beneficiaries, even if the exemption of the first spouse to die isn't exhausted.
- The top estate tax rate is bumped up to 40%. Not as low as the 35% rate in 2011 and 2012, but still better than the 55% rate slated for 2013 prior to ATRA.
- The estate and gift tax systems remain reunified. This means that the lifetime gift tax exemption is equal to the estate tax exemption of $5.25 million in 2013. (That's now the maximum exemption for combined taxable lifetime gifts and estate bequests.) Other provisions, including the generation-skipping tax that applies to most bequests and gifts to grandchildren, are coordinated within the system.

As a result of these changes, now is a good time to examine wills, trusts, and other aspects of your estate plan. Depending on your situation, revisions may be required or you might create a new trust to take advantage of the current estate tax law. ●

Straight Talk About Living Trusts

Ask two financial experts about the benefits of using a revocable living trust and you might well get precisely opposite reactions, especially on a regional basis. One might say that it's the greatest thing since sliced bread, while the other could argue that it should be avoided like the plague. The truth probably lies somewhere in between.

How does a living trust work? You set up the trust, transfer assets to it, and name a trustee to handle matters. If you designate yourself as the "initial beneficiary," you're entitled to receive income from the trust for the rest of your life. At the same time, you designate "secondary beneficiaries"—perhaps your spouse, your children, or both spouse and kids—who will receive the remaining assets when the trust terminates.

Significantly, you can still retain some control of assets in a living trust while you're alive. For instance, depending on the trust terms, you may be able to sell assets and keep the proceeds, amend terms of the trust (for example, change secondary beneficiaries), or revoke it entirely. The assets in the trust become irrevocable upon your death.

The main advantage is that assets in a living trust are exempt from probate, a process that may be required for assets bequeathed through a will. Proponents of living trusts note that the probate process can be costly and time-consuming. Also, if you face physical or mental limitations in your old age, with a living trust, a trustee for your assets is already in place.

However, detractors point out there are less expensive ways of avoiding probate, such as acquiring property jointly with rights of survivorship (although this may not be the best option in community property states). Also, the cost and complexity of probate is often exaggerated and can vary greatly from state to state. Finally, despite a common perception to the contrary, there's no estate tax advantage to using a living

IRS Reveals The Dirty Dozen Tax Scams

In what has become an annual rite of spring, the IRS has released the "Dirty Dozen" tax scams to watch out for in 2013. The list for this year is essentially the same as last year's, with a few minor tweaks. The scams are:

1. Identity theft. Once again, identity theft tops the list. Identity theft occurs when someone uses your personal information—such as your name, Social Security number, or other identifying information—without your permission, to commit fraud or other crimes. In many cases, an identity thief uses a legitimate taxpayer's identity to file a fraudulent tax return to claim a refund. If you believe you're at risk, contact the IRS immediately.

2. Phishing. Phishing is a scam usually carried out with the help of unsolicited emails or a fake website that prompts people to provide personal and financial information. Armed with this information, a criminal can commit identity theft or financial theft. You should report incidents to phishing@irs.gov.

3. Return preparer fraud. Most return preparers are honest, but some unscrupulous preparers prey on unsuspecting taxpayers. Choose carefully when hiring an individual or firm to prepare your return. Only use only preparers who sign the returns they prepare and enter their IRS Preparer Tax Identification numbers.

4. Hiding income offshore. Numerous people have been caught trying to evade U.S. taxes by hiding income in offshore banks, brokerage accounts, or nominee entities, using debit cards, credit cards, or wire transfers to gain access to the funds. Others employ foreign trusts, employee-leasing schemes, private annuities, or insurance plans. The IRS uses information gained from its investigations to pursue the crooks.

5. "Free money" from the IRS. Flyers and advertisements for free money from the IRS, suggesting you can file a tax return with little or no documentation, have been appearing in community churches around the country. These schemes promise refunds to people who have little or no income. They often are spread by word of mouth by unsuspecting and well-intentioned people.

6. Impersonation of charitable organizations. Following major disasters, such as Hurricane Sandy, it's common for scam artists to impersonate charities to obtain money or information from taxpayers. Some scammers operating bogus charities may contact people by telephone or email. They may contact disaster victims and claim to be working on behalf of the IRS.

7. False or inflated income and expenses. Including income that never was earned, either as wages or as self-employment income, in order to maximize refundable credits is another popular scam. Those who get caught could have to pay back erroneous refunds, including interest and penalties, and may be prosecuted.

8. False Form 1099 refund claims. Individuals have made refund claims based on the bogus theory that the federal government maintains secret accounts for U.S. citizens and that taxpayers can gain access to these accounts by issuing 1099-OID forms to the IRS. Typically, the perpetrator files a fake information return, such as a Form 1099 Original Issue Discount (OID), in an attempt to justify a false refund claim on a corresponding tax return.

9. Frivolous arguments. Promoters of frivolous schemes encourage taxpayers to make unreasonable and outlandish claims to avoid paying the taxes they owe. The IRS has a list of frivolous tax arguments that taxpayers should avoid. These arguments are false and have been thrown out of court.

10. Falsely claiming zero wages. A Form 4852 (Substitute Form W-2) or a "corrected" Form 1099 may be used to reduce taxable income improperly to zero. The taxpayer also might submit a statement rebutting wages and taxes reported to the IRS.

11. Disguised corporate ownership. Third parties are used improperly to request employer identification numbers and form corporations that obscure the true ownership of the business. These entities can be used to underreport income, claim fictitious deductions, avoid filing tax returns, participate in listed transactions, and facilitate money laundering and financial crimes.

12. Misuse of trusts. While there are many legitimate uses of trusts in tax and estate planning, some highly questionable transactions promise to reduce the amount of income subject to tax, to increase deductions for personal expenses, and to reduce estate or gift taxes. Such trusts rarely deliver the tax benefits promised. You always should seek the advice of a trusted professional before creating a trust. ●

trust if you retain the right to revoke it, as is typically provided. And even die-hard supporters of living trusts acknowledge you'll still need a will to tie up the loose ends of your estate.

So when does a living trust make sense? Consider these four key factors:

1. Age. Younger people in good health have less incentive to use a living trust than do retirees. Remember, a living trust will provide little benefit during your life.

2. Financial status. The more wealth you have, the more you're likely to benefit from a living trust. It will make things easier on your heirs if some or all of your assets bypass probate.

3. Marital status. If you're married and you own a house or other main assets jointly with your spouse, there's less need for a living trust. Furthermore, many states allow surviving spouses to use expedited probate procedures.

4. Confidentiality. One of the main arguments for a living trust is that your testamentary disposition remains confidential. This could be important for some families.

Don't be swayed by the hype of either point of view. Make an assessment of whether a living trust is right for you. ●

Find Extra Benefits In DI Insurance

The odds that you'll suffer a disabling injury or illness are far greater than the likelihood of you dying prematurely. A disability income (DI) insurance policy, used to supplement life insurance coverage, could help protect you from loss of income if you're unable to work. Indeed, a DI insurance policy might provide even more benefits than you expect.

Typically, a private DI insurance policy can pick up some of the slack if you're disabled for an extended time. Should you no longer be able to work, you will begin receiving a monthly disability benefit. Normally, the benefit is a predetermined amount, unlike employer-provided coverage, in which the benefit equals a percentage of compensation.

As with life insurance, DI terms can vary widely from policy to policy. Some key variables include the amount of the benefits you'll receive; the length of the coverage; the requirements for receiving full benefits; the definition of "disability"; the length of the waiting period before benefits begin; any cost-of-living adjustments; availability of partial benefits; and possible non-cancellation features. Naturally, the cost of the premiums also will vary, depending mainly on those variables.

But don't assume that you must be bedridden to collect any benefits. Frequently, a DI insurance policy will provide "residual benefits" in the event you can work some of the time or if you're slowly getting back on your feet. Some policies even offer benefits after you've returned to work if you are earning less than you did before your disability.

The residual benefits generally kick in when the loss of income is greater than 20% of previous earnings and the decline is due to the medical condition underlying the disability. This feature could be especially valuable to small business owners, including self-employed entrepreneurs, and professionals in fee-based practices, such as physicians, attorneys, and accountants.

For example, suppose a surgeon recovering from a severe illness returned to practice but was able to see fewer patients. If the surgeon's income was reduced from $50,000 a month to $30,000, the residual benefit could restore income to 80% of the pre-disability level—in this case, $40,000 a month. Similarly, if the side effects of chemotherapy make it too hard for a litigator to appear in court or for a CPA to handle a company's books, the residual benefits can soften the economic blow.

To see what your coverage may or may not include, take a close look at existing DI policies or any new policy you're considering and have your insurance agent explain the residual benefits section. The policy might be more valuable than you imagined or the residual benefits may be too restrictive. Those provisions could be a key component of your DI insurance coverage. ●

Power Of Diversified Portfolios

(Continued from page 1)

asked in his presentation.

To find out, he analyzed the performance of a simple two-asset portfolio during those same two time periods, cutting bonds to 40% of the portfolio and adding large U.S. stocks as 60%. Not surprisingly, adding returns from the more volatile equities market increased the portfolio's annualized return to 8.52% during the 1948-1981 timeframe and to 10.56% during the later period.

Then Israelsen moved into a more diversified portfolio with four asset classes: 40% large U.S. stocks, 20% small U.S. stocks, 30% bonds, and 10% cash. That resulted in a 9.52% annualized return in the earlier period and a 9.99% return in the later period.

The increasing rates of return for the earlier period—and the decreasing differences between returns for the two time periods—clearly shows the benefits of diversification. Bonds alone produced positive returns, but when combined with equities, the returns rose – regardless of which way interest rates were moving.

Some investors may look at these figures and wonder why they shouldn't simply eliminate bonds and put all their assets into equities. The answer involves risk and an investor's time horizon. In general, U.S. equities tend to have two to three years of negative returns during every 10-year period. That increases the risk your portfolio might take a hit just before you intend to retire or before you need to make a withdrawal for other reasons.

Bonds experience an average of two very slight negative-return years per decade, so they provide a stabilizing influence that can smooth out your portfolio's performance. That's the whole point of diversification, to avoid putting all of your investment dollars at risk at the same time.

A final point: Periodic rebalancing is vital, because as asset classes rise and fall in value, your portfolio mix will change. If you start with 30% in large U.S. stocks and this class performs well, that portion of your portfolio may grow to 35% or 40% of the whole, throwing off the balance in the portfolio. So you have to rebalance, either by selling some of the large-stock holdings or buying more in your other asset classes.

Our firm can help you with each aspect of meaningful portfolio design—asset allocation, risk management, and rebalancing – within the context of your overall financial situation and life goals. ●

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