INVESTMENT MANAGEMENT & CONSULTING GROUP

VIEWPOINTS

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MARKET COMMENTARY

FREDRIC W. WILLIAMS

Skeptical, At Best…

Despite robust rebounds in the equity markets during the most recently completed quarter, individual investors focused on the glass being half empty and voted with their feet as they continued to exit stock funds for the perceived "safety" of the bond market. From weak jobs and housing data to European sovereign debt concerns, chatter about a looming "double dip" or the deflation/inflation debate, there were a litany of issues staring down near term portfolio performance as the fall equinox approached. It would appear that after riding the markets down in 2008 and then back up in 2009, the retracement in 2010's 2nd quarter brought a whiff of fear back in the markets and prompted the sprint to the investment bunkers by trigger- happy investors trying to protect their portfolios.

> *"As they have for much of the past two years, investors in the third quarter continued to pour spare cash into bond funds and snub stock funds, as new-debt issuance broke records and interest rates fell toward generational lows…*
>
> *"During the third quarter, bond mutual funds took in an estimated $87 billion, according to the Investment Company Institute, bringing the total net new investments in bond funds since the start of 2009 to $620 billion.*
>
> *"Meanwhile, investors pulled $43 billion out of U.S. stock funds over the past three months and have withdrawn $100 billion since the beginning of 2009, according to Morningstar."* *WSJ 10/1/2010*

Typically (and unfortunately) individual retail investors tend to be contrarian indicators in that their actions are reactive, looking out the rear view mirror, rather than pre-emptive in evaluating what might lie just over the investment horizon. Although only time will tell if their migration to bonds will resemble moving from the frying pan into the fire, based on a turn in interest rates negatively impacting the fixed income markets, but our sense is that with rates pretty much as low as they can go, there likely may be a repeat of past investment history.

> *"Retail investors certainly don't have a good track record when it comes to buying bond funds in masse. They pumped tens of billions of dollars into them in early 1987, right before rates shot up and bonds got pounded; the same thing happened in 1994."* *WSJ Intelligent Investor 10/1/2010*

Add to this the backdrop of the still perplexing flash crash, the existence of so-called dark pools, along with high frequency traders, and it's easy to see why the individual investor might view the markets as casino-like with the Goliaths holding most of the cards. Absent some form of discipline to employ as an objective and unemotional asset allocation guide it could be understandable that they see current investment opportunities as offering similar odds to those of battling a forest fire with a plastic squirt gun.

Given how significant a role the consumer plays in our GDP (approximately 70%), confidence and sentiment are key indicators when trying to determine the level of "activity" families and individuals will contribute to the economy. Therefore the condition of the jobs and housing market become extremely important determinants in how the consumer perceives the condition of their financial well being. With unemployment high and the housing market continuing to struggle, the propensity for consumption is diminished and the rate of savings increases as individuals anticipate a future of rainy days without jobs or a house that has equity. Domestically we've gone from a negative savings rate at the start of the decade, to one over 5% (August's national savings rate was 5.8%, up from 5.7% in July), and although increased savings is good for the long term health of our economy, it can curtail growth in the short term as it comes at the expense of consumption which contributes to additional economic activity.

In the midst of all the aforementioned malaise, it can be instructive to consider the opportunities that may exist in this environment of general unease. We're reminded of one of the Oracle of Omaha's observations where he suggests that one should "attempt to fearful when others are greedy and greedy only when others are fearful." And although we don't anticipate uninterrupted clear sailing going forward, we do see a number of factors that are coming together that may support a more positively constructive view of relative equity market performance over the longer term.

One is the fact the corporations are flush with cash – something that, once the legislative policy paralysis is resolved in Congress, could be deployed for stock repurchases or dividends.

> *"As of June 30, the most recent data available, industrial companies in the Standard & Poor's 500-stock index had a record $843 billion of cash on their books, up from $773 billion a year earlier, according to S&P. That recent reading was equal to a record high 11.6% of those companies' stock-market value, nearly double the average reading from 1980 through the end of 2007.*
>
> *"That ought to be good news for investors because those companies eventually have to do something with all that money.*
>
> *"One option is stock repurchases, which can help support stock prices by reducing the number of shares in circulation. Yet, announcements of stock buybacks have actually fallen over the course of 2010, from $110 billion in the first quarter to $61 billion in the third quarter, according to Dealogic. Those levels are well below the pace of 2006 and 2007, and many analysts see room for repurchases to grow.*
>
> *"Another is dividends, which fell sharply in the wake of the financial crisis. Fueling chatter about higher dividends was Microsoft Corp.'s move in September to raise its dividend 23%.*

"Dividends have begun to recover, but only slowly. During the first nine months of 2010, S&P 500 companies lifted their payouts by $15 billion. During the comparable period in 2009, dividends on the S&P had been reduced by $40 billion.

"Many of those disappointed by the level of buybacks or dividend increases point to Washington, where there is uncertainty about tax laws and regulation."

WSJ 10/1/2010

Another is the relative valuation comparisons that have evolved as a result of the previously discussed stampede from the equity to fixed income markets. With 10 year Treasurys yielding just over 2.5%, we think the current dividend yield offered by the Dow Jones Industrial Average of 2.6%, which is supported by an earnings yield of 6.84%, or the Dow Jones Utility Average with a dividend yield of 4.31% and an earnings yield of 7.59% offer a better opportunity to benefit from a gradually recovering, and re-inflating, economy in the future. Additionally, we see the possibility of a reverse migration from the bond market as rates rise and retail investors come to understand that although bonds can be safe, they can also be risky if not acquired at the proper time.

In the equity markets one strives to "buy low and sell high" from a pricing perspective. Doing the same in the bond market now would require yields to drop further, something that may be mathematically challenging. We suspect that the only "low" being purchased now are bond yields, not bond prices, and that a eventual uptick in rates is only going to push bond prices lower. We would therefore expect this dynamic, which would likely occur as the economic outlook improves and the Fed ceases to suppress rates, to push assets out of the bond market and toward the longer term opportunities for income and growth in the equity markets. As such, we'd stick with our closing comments from last quarter:

"…longer term market participants should first determine what they need, and when, from the investment process – and then make systematic deployments accordingly. Trying to time the markets, in an attempt to identify the perfect exit and entry points, is an exercise in futility and increased risk. Albeit quaint, figuring out which road will get you to your destination is the best first step – and is one that should be reviewed regularly. The fuel to move you down that road is the cash flow derived from the allocation of ones assets, which may not necessarily be correlated with what the media's talking heads are buzzing about on any given day."

EQUITY MARKET OVERVIEW — INVESTMENT POLICY COMMITTEE

This Looks Familiar…

After the 2nd quarter's assorted global challenges, from Euro stress to the recently "explained" flash crash, equity investors in the Q3 2010 resembled a somewhat manic "cat on a hot tin roof" pushing the markets higher in July, retreating in August and then rallying once again through September. As mentioned above, it appears that the portfolio wounds of 2008 were refreshed with the 2nd quarter pull back, causing individual investors to continue their exodus from the equity markets and locking the indices in a trading range dominated by the macro forces of economic and political uncertainty. At the end of the quarter, and all the summer's various dramas, the domestic stock markets were sitting almost exactly where they were six months ago at the end of March.

The 2nd quarter's losses were made back as the Dow Jones Industrial Average rallied 10.4% in the quarter, leaving it up 3.5% for the year, while the broader S&P 500 moved ahead 10.7% [up 2.3% year to date], and the NASDAQ jumped 12.3%, hitting the three quarter mark up 4.4% thus far in 2010.

Despite the announcement that the recession "ended" in June of 2009, it was difficult to celebrate given the continued high unemployment rate and the challenges still facing the housing market. Late in September the National Bureau of Economic Research announced that the recession had bottomed out in mid 2009 and represented the longest downturn (aptly dubbed "The Great Recession" by the media) since World War II, outlasting a pair of 16-month slumps in 1973-1975 and 1981-1982.

> *"Although the U.S. economy expanded at a sharp 5.0% pace in the final three months of 2009, growth slowed to 3.7% in the first quarter and 1.6% (initial revision) in the second quarter to renew concerns about another downturn"* *MarketWatch 9/20/2010*

> *"The third estimate of Q2 GDP growth by the Bureau of Economic Analysis came out higher than economists expected: the second estimate of 1.6% offered in August was actually revised UP to 1.7%, whereas Economists had expected the Bureau to stick with 1.6%. The preliminary estimate in July was 2.4%."* *Barron's 9/30/2010*

Unemployment remained high, although the August data and end-of-September initial claims numbers offered a glimmer of hope for the 14 million (U-1) to 24 million (U-6 measure) Americans un- or under- employed.

> *"The U.S. economy lost jobs for the third month in a row in August, but modest hiring by the private sector eased concerns the economy might be tumbling back into recession.*
>
> *"Private-sector employers added 67,000 jobs on a seasonally adjusted basis, the Labor Department said Friday. Overall, nonfarm payrolls fell by 54,000, as the U.S. shed 114,000 temporary Census workers and state governments also reduced employment.*
>
> *"The jobs report was consistent with other recent economic reports, including a strong factory report earlier this week, that show the economy continues to recover, though at a painfully slow rate.*
>
> *"The unemployment rate ticked up to 9.6% from 9.5% in July, not because of layoffs but because more people entered the work force. Some 14.9 million people remain jobless, and the unemployment figure marked the 16th straight month above 9%, the longest stretch in a quarter-century."* *WSJ 9/4/2010*

> *"The number of people who signed up for state unemployment benefits fell 16,000 to a total of 453,000 in the latest week, the Labor Department reported Thursday, leaving the level of new claims back where they were at the start of 2010.*
>
> *"Economists polled by MarketWatch had expected initial claims to rise to a seasonally adjusted 460,000 in the week ended Sept. 25. Claims for the prior week were revised up by 4,000 to 469,000.*

"A more accurate gauge of employment trends is the four-week average of initial claims, which is less volatile than the weekly number. The moving average also fell, down 6,250 to 458,000 to mark the lowest level since late July." *MarketWatch 9/30/2010*

Overseas markets followed their domestic brethren with the bulk of the developed and developing bourses posting positive numbers for the 3rd quarter. London's FTSE 100 advanced 12.9%, hitting the three-quarter mark up 2.5%, Frankfurt's DAX was up a more subdued 5%, ahead 4.6% as Oktoberfest approached, while the Paris CAC 40 jumped 8.3%, up 5.6% year to date and Tokyo's Nikkei, struggling with the impact an appreciating yen had on their export focused economy, finished the quarter down 1.4% in the quarter and 11.4% thus far in 2010.

"Suddenly, the world is feeling like a better place.

"After a harrowing second quarter dominated by the European sovereign-debt crisis and fears of a double-dip recession in the U.S., investors around the world shook off most of their jitters and embraced a rosier, if not entirely clear, global economic picture.

"Global stocks posted strong gains as investors grew more comfortable that the worst may be over for the world's largest economy, the U.S., allowing them to focus on compelling domestic growth stories in a number of emerging markets." *WSJ 10/1/2010*

The re-emergence of the growth story being outside of the of the U.S. was evidenced once again with the rebound in the developing world's stock markets. Within the BRIC complex, Brazil was up 14.8%, to go positive by 1.2% for the year, Russia rallied 9.9%, up 2% year to date, India moved ahead 12.3%, posting an impressive increase of 14.9% year to date, while China rebounded 11%, but was still down 19% for the year. Given the demographics (younger), population (80% of the globe's head count) and fiscal condition (most of the major developing countries are running surpluses and have significant reserves) of the emerging economies, it seems probable that relative growth will be more prevalent in the developing world in the future.

We, however, will not overlook the opportunities in the developed world given valuations and dividend income generation that now exists in our post-crisis markets. With bond yields driven to relative and absolute lows as individual investors have withdrawn assets from equity funds and reallocated them to bond funds, we see credence in the contrarian position that suggests longer term stock market outperformance relative to bonds. As noted in this space last quarter, we believe the ongoing deleveraging process, for both individuals and institutions, will result in a subdued growth environment that favors the total return mantra of current dividend cash flow and gradual future appreciation.

BOND MARKET OVERVIEW — INVESTMENT POLICY COMMITTEE

Looking for Mr. (Ms.) Good Yield…

Rebounding from a bout earlier in the year with a bond strain of the "swine flu" (concerns about the European PIIGS economies and their relative fiscal health), the domestic credit markets benefited from a continued flight to yield, with demand for fixed income investments pushing prices up and current yields down. Although up for the quarter, the bond market advance was less muted than in previous quarters, primarily due to the proximity of current yields to zero, thereby limiting the magnitude of any upside advances in price. Unlike last quarter's fear induced run to the dollar which primarily benefited Treasuries, investor appetite for increased income pushed their demand further out both the risk and duration spectrums – something that will likely be second guessed when rates inevitably turn and head higher in the future.

While Treasurys were up 2.7% in the 3rd quarter, investment grade corporates jumped 4.9% and saw their spread over Treasurys narrow 25 basis points to 1.84%, indicating that the flight to quality run in the 2nd quarter was subsiding as investors grew more comfortable with the stability of non-sovereign debt. The Fed's continually stated policy to keep short rates nailed close to zero for the foreseeable future pushed current yields even lower, with the 2 year note closing the quarter at 0.43%, down from 0.63% at the end 2nd quarter, and the 10 year went from 2.96% at the end of June to 2.519% at the end of September and well off April's high of 4.017%. Even the nostalgic 30 year bond saw its yield pulled lower, closing at 3.684% to conclude 2010's 3rd quarter.

Corporate borrowers have jumped at the opportunity to reduce their borrowing costs, while taking advantage of this low interest rate environment and investor demand, illustrated by the previously mentioned flow of funds data on the part of individual investors.

> *"Still, with cash yielding next to nothing, slow economic growth and memories of multiple stock-market slides still fresh, investors are hungry for assets that churn out regular income and they are seeking them in the bond market.*
>
> *"Corporate treasurers have obliged by pumping the market full of fresh debt for investors to buy. High-yield borrowers, or those with credit ratings below investment-grade, issued nearly $190 billion in the third quarter, according to data provider Dealogic. The year has already broken the annual record for "junk bond" issuance, with one more quarter still to go.*
>
> *"Investment-grade issuance was nearly $612 billion in the third quarter, according to Dealogic. That issuance is off 2009's record pace, but demand for the debt of solid corporate borrowers such as Microsoft Corp., Johnson & Johnson and McDonald's Corp. was so strong that those companies were able to borrow at the lowest rates in decades.*
>
> *"Analysts expect another busy issuance calendar in the fourth quarter. Debt-finance chiefs at Bank of America Merrill Lynch, for example, are forecasting up to $175 billion in investment-grade bond issuance this quarter and $35 billion in high-yield issuance."* *WSJ 10/01/10*

Given that central bank driven rate increases are pretty much off the table for now, the focus on the F.O.M.C. has now shifted to their recently announced inclination to do anything necessary to further stimulate the economy. With further reductions in the Fed funds rate arithmetically challenging, the only option left is additional quantitative easing – affectionately dubbed QE2 by the financial media. After hinting earlier in the year that the Fed intended to shrink its balance sheet, the slower than desired recovery is prompting the central bank to go back to the well and acquire additional government debt as a means of injecting additional cash into the economy in an attempt to foster an increase in economic activity. The premise for this is based on the belief (not having worked yet it can't be construed as "fact") that the banking system would then put these dollars to work in the form of loans that could promote business activity, job growth and consumer spending. The only fly in the ointment with that theory is that banks have seen lending contract significantly over the last two years, as a result of both tighter standards and an absence in demand, bringing into question the viability of the Fed's hoped for "money multiplier" effect that such a cash injection is targeted to achieve. Banks, just like most other businesses, are hoarding any cash they can get their hands on given the legislative, tax and policy uncertainties emanating from our pals on Capitol Hill. With Congress in now in the throes of mid-term elections, we don't see much clarity from our lawmakers before the lame-duck session is replaced in January.

Although our investment discipline continues to see the long term value in the fixed income foundation that prudent portfolios should be built upon, we believe that with rates at generational lows, bond allocations need to strive to keep maturities in the short to intermediate range, maintain a laddered structure to spread out interest rate risk, and add to inflation protected and floating rate allocations both domestically and abroad as hedges against rising rates and currency fluctuations. With the compounding of cash flow such a significant factor in generating consistent long term rates of total return, we will also consider taking advantage of the current dividend yield environment as a potential bond proxy that can also benefit from an eventual recovering and inflating economy.

WEALTH MANAGEMENT UPDATE

Student Loan Forgiveness & Loan Repayment Programs TRACY W. ROGERS

Continuing our ongoing series of articles related to college financing, this quarter we will highlight loan forgiveness & repayment programs. These programs offer to eliminate some or all of your student loans in return for choosing certain careers (for example, military service). In addition to the widely advertised military programs ("join the Guard, get money towards college!") for college funding, there are programs also available in the following fields: volunteer, teaching, dental, nursing, law enforcement, veterinary, and legal and medical studies. Such programs can eliminate anywhere from a few thousand dollars to over $100,000 of student loans. Ironically, many of these programs receive a relatively small number of applications indicating that many graduates are completely unaware of these opportunities. That's where we come in – the following list will highlight some of the programs and the corresponding resources available:

Department of Health and Human Services (National Institute of Health – NIH)
Web site: http://services.aamc.org/fed_loan_pub

The NIH offers a Loan Repayment Program to individuals who are prepared to use their clinical research skills to help with the development of medical treatments for diseases and illnesses. The NIH Loan Forgiveness program repays 25% of a doctor's student loan balance per year ($35,000 maximum each year), for doctors conducting research. Research must be conducted in one of the following areas: Clinical, pediatric, health disparities, contraception and infertility, clinical for doctors from a disadvantaged background or AIDS.

To be eligible for NIH loan repayment, a medical professional must be a U.S. citizen or permanent resident and hold one of the following doctoral degrees: M.D., Psy.D., D.O., D.M.D., D.P.M., D.C., N.D.

Certain health professionals can receive up to $50,000 of student loans forgiven through the National Health Service Corps Loan Repayment Program in exchange for two years of volunteer service at a clinic that has a shortage of health professionals. You may be able to receive additional forgiveness for additional service.

Nursing
Web site: http://www.hrsa.gov/loanscholarships/repayment/nursing

The Nursing Education Loan Repayment Program (NELRP) is a selective program of the U.S. Government that helps alleviate the critical shortage of registered nurses currently experienced by certain types of non-profit health care facilities by helping nurses working at them to repay their student loans. In exchange for two years of service, participants receive 60 percent of their total qualifying nursing education loan balance. For an optional third year of service, participants may receive 25 percent of their original total qualifying nursing education loan balance. Participants also receive the salary and benefits they have negotiated with their employing facility.

Law School Loan Repayment Assistance Programs
Web site: http://equaljusticeworks.org

Lawyers who agree to serve in the public sector or represent non-profit organizations may have a portion of their student load debt forgiven by their law school. In addition, the American Bar Association and Equal Justice Works (formerly the National Association for Public Interest Law) maintain databases and information on loan forgiveness programs. Equal Justice Works discovered that two-thirds of Law Schools surveyed offered a student loan forgiveness program.

American Federation of Teachers
Web site: http://www.aft.org

College graduates who plan to pursue a teaching career have an excellent chance of achieving college loan forgiveness. There are a number of programs displayed at AFT.org. Although the criteria are different for each program, the database is searchable by state. According to FinAid.com, The National Defense Education Act allows the United States government to forgive a percentage of a college graduate's Perkins loans in exchange for teaching elementary or secondary school in low-income areas. The program allows for 15% of the loan total to be forgiven for the first and second years of service, 20% for the third and fourth years, and 30% for the fifth year.

Veterinary

Web site: http://www.nifa.usda.gov/nea/animals/in_focus/an_health_if_vmlrp.html

The US Department of Agriculture's Veterinary Medicine Loan Repayment Program (VMLRP) offers loan forgiveness of $25,000 per year for three years for veterinarians who commit to work in a NIFA (National Institute of Food & Agriculture)-designated veterinarian shortage situation for a period of three years.

Volunteer

Web sites: http://www.americorps.gov, http://www.peacecorps.gov

Certain volunteer organizations offer student loan forgiveness in exchange for a certain amount of your time. If you volunteer for AmeriCorps or Peace Corps, you can have up to 70% of your student loans forgiven. Visit their websites to find out more information about student loan forgiveness programs.

Public Service Loan Forgiveness

Through the College Cost Reduction and Access Act of 2007, Congress created the Public Service Loan Forgiveness Program to encourage individuals to enter and continue to work full-time in public service jobs. Under this program, borrowers may qualify for forgiveness of the remaining balance due on their eligible federal student loans after they have made 120 payments on those loans under certain repayment plans while employed full time by certain public service employers. Since borrowers must make 120 monthly payments on their eligible federal student loans beginning after October 1, 2007 before they qualify for the loan forgiveness, the first cancellations of loan balances will not be granted until October 2017.

What types of public service jobs will qualify a borrower for loan forgiveness under this program?

The borrower must be employed full time (in any position) by a public service organization, or must be serving in a full-time AmeriCorps or Peace Corps position. For purposes of the Public Service Loan Forgiveness Program, the term “public service organization” means:

- A federal, state, local, or Tribal government organization, agency, or entity (includes most public schools, colleges and Universities);
- A public child or family service agency;
- A non-profit organization under section 501(c)(3) of the Internal Revenue Code that is exempt from taxation under section 501(a) of the Internal Revenue Code (includes most not-for-profit private schools, colleges, and universities);
- A Tribal college or university; or
- A private organization that is not a for-profit business, a labor union, a partisan political organization, or an organization engaged in religious activities (unless the qualifying activities are unrelated to religious instruction, worship services, or any form of proselytizing) and that provides the following public services:
    - *Emergency management; Military service; Public safety; Law enforcement; Public interest law services; Early childhood education (including licensed or regulated health care, Head Start, and state-funded pre-kindergarten); Public service for*

individuals with disabilities and the elderly; Public health (including nurses, nurse practioners, nurses in a clinical setting, and full-time professionals engaged in health care practioner occupations and health care support occupations); Public education; Public library services; and School library or other school-based services.

This is not a comprehensive listing of all programs available, but it highlights several of the more prominent options. Each state may offer its own programs and qualifications. Many of these programs are under-utilized, so it never hurts to take a chance and inquire as you're going through the planning and preparation process.

Special Needs Trust Planning FRANCIS J. DAVIES III

Last month I met with a unique group of parents at the MaineHealth Learning Resource Center. Along with an excellent trust and estates attorney, we presented a program on the unique legal and financial concerns these parents face raising special needs children. The seminar was filled to capacity and the information so welcomed that I felt it important to share it with you. The most important overriding message is that there is help available and that there are ways – legal and financial - to protect and provide for a special needs dependent. Most of this information also applies to other areas of financial planning.

<u>Insuring Your Wishes are Met Even When You're not There</u>

The process of providing for the future of a special needs child begins with research. The first thing you will learn once you begin digging is the importance of assembling a trusted team of advisors. To help you with the many legal and financial issues unique to special needs dependents, you will need a good attorney, one who is both familiar with the details of structuring a trust and capable of communicating with the client, and an accountant to address the tax issues for the benefactor and the recipient. IMCG regularly helps our clients to find professionals that they are comfortable with to fulfill these roles. The chart below illustrates the steps involved, from team building to final plan.

With special needs children, the one constant is change. As parents we want a legal contract that can stand in our shoes. The goal of a special needs trust is to put in place a legal structure that will provide for your child if you are not here to do so yourself. The structure needs to stand up in court, maintain the child's eligibility for public assistance, and have the capacity to adapt to change. One of the best ways to express our desires is a Memorandum of Intent. Like a Living Will does for family members, the Memorandum of Intent provides your chosen guardian with instructions regarding your intentions for the care of your child. While this is not the legal document itself, it is a great forum to make clear how you want your child to be raised.

The Dilemma – Saving for the Future while Living in the Present

> "*The test of a first-rate intelligence is the ability to hold two opposed ideas in the mind at the same time, and still retain the ability to function. One should, for example, be able to see that things are hopeless and yet be determined to make them otherwise.*"
>
> *F. Scott Fitzgerald*

Parents of special needs children face a difficult balancing act. On the one hand, there is a desire to provide for the child's future, which means putting aside money in the trust. On the other hand, there is the reality of day-to-day expenses: occupational therapy, speech therapy, transportation and extra help – the interventions available for the child for quality of life today that can significantly improve the chances of a productive life tomorrow.

Add to that the demands of managing health care (the hours spent on the phone with the insurance company getting pre-approvals which then may be reversed after the fact), time spent at the public school arguing the child's case for special help, and all the time spent to make the child's everyday quality of life the best it can be. After these daily battles, the task of constructing and funding a trust may seem daunting. Taken a bit at a time, it does not have to be overwhelming.

Where to Start

One way to fund a trust is through life insurance. In my experience, almost every Special Needs Trust includes some type of insurance. Since we do not sell insurance at IMCG, we are able to provide our clients with an informed and unbiased opinion of what they should consider. We help them look at the costs, benefits and short comings of whole life, term and universal life insurance policies. We then work with an insurance provider to find the best policy to address the client's unique needs at a fair price.

Only after all this preparation is finalized can we start addressing investment options. Our concentration on low volatility, cash-generating investments combined with low costs is very appropriate for a situation such as a special needs trust. Remember, this involves extremely long-term planning, beyond the time frame of funding education or retirement accounts.

With the trust funded, we can add value in our primary role as the investment advisor. As fiduciaries we are required by statute to work in your best interest. This makes IMCG uniquely qualified to fulfill your stated goals. The transparency of our advice, vested interest in our clients and ability to collaborate directly with the legal team is a solid foundation for the team approach. The final step – reviewing and refreshing the plan – is vital here as it is in all investment portfolios.

FIDUCIARY CORNER STEPHEN L. EDDY

2010 is not so quietly becoming the Year of the Retirement Plan Fiduciary.

On July 21, 2010 President Obama signed the Financial Reform Bill into law. Focused on consumer protection, financial market reform and regulatory agency overhaul, the bill was a result of public outcry against the nation's insurance, banking and investment industries, and (perhaps most importantly) their regulators, for their roles in the market crash of 2007-2008. Among the most visible items addressed were tighter regulation of hedge funds, executive compensation curbs, a more transparent Wall Street and mortgage reform.

One issue that was part of the President's original proposal but not resolved by the bill was the concept of brokers and broker-dealers being held to the same fiduciary standard that Registered Investment Advisors (RIA) are held to – ***namely, every decision needs to be made in the best interest of the client, or in the case of retirement plans, the plan participants.*** [Editors note: In the interests of full disclosure, IMCG is an RIA. But you already knew that.] Instead of implementing this sorely needed common sense change, the legislation directed the SEC to study the issue for six months before making a recommendation. Why?

Simply put, there was an all-out behind the scenes lobbying battle in the months leading up to the final version of the legislation. On the one side, you had RIA's, independent fiduciaries, plan sponsors and congressional lawmakers arguing for a fiduciary standard to which everyone is held; on the other side, you had the brokers, broker-dealers, insurance companies, and their respective industry groups, arguing that such a change would cause confusion and limit their ability to sell. As *The Investment News* reported in the May 11, 2010 issue:

> *"Advocates for the fiduciary standards are battling an equally strong effort by brokers and insurers opposed to imposing the requirement on brokers. They claim that such a standard would limit their ability to charge commissions and offer proprietary products."*

Wait. What??? A fiduciary standard "would limit their ability to charge commissions and offer proprietary products"? No wonder they didn't like the proposed legislation. It cuts into the bottom line. When asked about the fiduciary standard issue, John Bogle, founder of The Vanguard Group, was quoted as saying:

> *"As the good book says, no man can have two masters"*
> *Investment News, March 19, 2010*

In other words, it is inherently impossible to offer unbiased fiduciary investment advice that is in your client's best interest if you receive any kind of commission or other compensation from the mutual funds or retirement plan platform that you are recommending, or if you limit the platform search based on how those platforms pay you.

So, with regard to fiduciary investment advice for retirement plans, should brokers and insurance agents be held to the same higher "in the client's best interest" standards of Registered Investment Advisors? We think so.

To understand how the application of the fiduciary standard impacts retirement plans, we need to first understand the different types of fiduciaries as contemplated under the Employee Retirement Income Security Act of 1974 (ERISA). There are four types of "named" fiduciaries under ERISA. To be a named fiduciary you have to be literally named in the plan document or be identified as responsible for a particular aspect of the plan. The four are:

1. **The ERISA section 3(21) Named Fiduciary** – usually the plan sponsor, the Named Fiduciary controls the other three types of fiduciaries, and is responsible for hiring, appointing and monitoring them. W. Scott Simon, an expert on the issue and contributor to the Morningstar Advisor, calls the ERISA section 3(21) Named Fiduciary "The Mother of All Fiduciaries".
2. **The ERISA section 3(16) Plan Administrator** – also usually the plan sponsor, essentially a "coordinator of communications", responsible for all plan disclosures to participants and all filings with the federal government.
3. **The ERISA section 403(a) Trustee** – contrary to popular opinion, this is NOT the "directed-trustee" that many banks and other custodians of assets claim to be, but according to ERISA, an employee or employees of the plan sponsor with exclusive authority/discretion over management/control of plan assets. Think "Retirement Plan Committee" or "Investment Committee".
4. **The ERISA section 3(38) Investment Manager** – usually a third party, hired by the 3(21) Named Fiduciary with sole responsibility to select, monitor and replace a plan's investment options. If hired, supersedes the 403(a) Trustee regarding the discretion over plan assets.

The first three types of fiduciaries on the list are named in the plan/trust document, and usually don't generate much confusion when it comes to understanding their roles and responsibilities to the plan and the participants. The same plan/trust document is the guiding document for each of them and has a common set of rules that they must follow.

Conversely, the ERISA section 3(38) Investment Manager is usually named under a contract separate from the plan document. This is where the confusion begins. Any separate document or contract has its own unique features and clauses. It is incumbent on the 3(21) Named Fiduciary to make sure they understand the contracted services provided and the liability covered by anyone monitoring the investments of their plan, since they retain the ultimate responsibility for hiring, monitoring and replacing of plan fiduciaries.

Since the Named Fiduciary is usually the plan sponsor (i.e., the widget maker), their primary expertise is not interpreting contracts with fiduciaries, but making widgets. Where should they turn to ensure that they are getting the proper fiduciary guidance for their plan's investments? Might I suggest a good ERISA attorney as a first step? The second step is to hire a true ERISA section 3(38) Investment Manager. This moves the investment component of fiduciary liability from the shoulders of the plan sponsor, and places it squarely on the shoulders of the 3(38) Investment Manager. The determination of whether or not you have hired a true fiduciary is found in the wording of the 3(38) Investment Manager's contract/services agreement.

How can you determine the differences between an RIA and a broker that each claim to offer these services?

As readers of this newsletter know, the RIA is always obligated to operate in their clients best interests, and those RIA's that focus on investment monitoring for retirement plans are true named fiduciaries under ERISA section 3(38). Unfortunately for plan sponsors, there are some very good product salesmen out there. There are many broker-dealers and insurance companies that claim to be "co-fiduciary" with regard to the investments for retirement plans. They tout their "trustee-level" monitoring reports, their fiduciary designations (that they paid for), their "partnerships" with Morningstar, and great tools they offer to help the plan sponsor be a better fiduciary. However, as "co-fiduciary" they don't shoulder any of the plan sponsor's liability because they refuse to be a discretionary component of the investment process. As Simon writes in a Morningstar Advisor article from April 2008:

> *"…since there's no discretion, there's no real transfer of responsibility and therefore no mitigation of any potential liability. Plan providers such as broker/dealers and insurance companies that peddle this to plan fiduciaries as some sort of "solution" create the illusion that they stand alongside the fiduciaries in equal fiduciary solidarity. The term "co-fiduciary," [is] a marketing gimmick… [an] illusion which is endorsed by leading advertising firms and the marketing departments at many broker/dealers and insurance companies."*

Questions to ask when you are selecting an ERISA section 3(38) Investment Manager:

- Are you willing to be a named investment fiduciary as contemplated under ERISA section 3(38)? If so, please show me where it is documented. And please, none of that "co-fiduciary" gibberish.
- As fiduciary, do you remove the fiduciary responsibility and liability with regard to the investments from my shoulders? Are you legally liable for your decisions, and do you stand in front of me if we go to court?
- Can you confirm that you are solely fee-based and do not get paid at all by the funds or the platform you recommend in return for giving them my business?

If the answer is "no" to any of the above questions, you likely have the wrong ERISA section 3(38) Investment Manager. How many masters does your retirement plan advisor have?

Next quarter, we'll review the latest on the SEC 12b-1 fee proposals, as the Year of the Retirement Plan Fiduciary moves ahead.