

The Key to Happier Beneficiaries:

Investment Consulting and the Total

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The income beneficiaries of many traditional income-paying trusts have recently watched their incomes decline while the trusts' investment portfolios may have appreciated up to 11 percent to 12 percent annually. The twin culprits of this lopsided transformation are current dividend yields and interest rates. These two components of a portfolio's return historically define the "income" that is paid to a trust's income beneficiaries. Unfortunately, for today's income beneficiaries, dividend yields are only one-third of what they were 20 years ago. And the interest rates on bonds, particularly short-term instruments, are near their all-time lows.

A Delaware Total Return Unitrust (TRU) does not limit the payments to income beneficiaries to only the actual income generated by the trust, but instead allows a percentage of the trust's value to be distributed each year. The difference can be significant. For example, converting an income-trust to a TRU could take an income beneficiary

from a payment stream of 1.6 percent annually to one of 5.0 percent.

The goal of a TRU is to generate enough total return (asset appreciation, interest, and dividends) to make the required payments to the beneficiaries, pay taxes, and allow for inflation. And trustees are given greater flexibility in their investment allocation decisions than they may be allowed under traditional income-paying trusts.

When an income-trust is converted to a TRU, the trustees are no longer required to hold a majority of the portfolio in bonds, which has historically limited the opportunity for trust principal growth. Low-dividend-paying stocks, and even asset classes that have almost no yield, such as private equity or small cap stocks, might be able to be added to the portfolio without affecting the beneficiaries' payments. This strategy, over long periods of time, should not only increase the payouts but should also increase the average total return and ultimately the value of the trust's holdings.

New Parameters for Investing Trust Assets

Asset allocation is the key to favorable, long-term investment results and controlling risk. There are four primary ways to look at diversification. The first is across asset classes, such as domestic versus international equities. And, because asset classes behave differently from one another, an investor should be able to add return without compromising risk by taking an egg from each one of these baskets.

The second scope of diversification is across styles – value and growth. Value stocks tend to have lower price/earnings ratios, lower price/book ratios, higher

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dividends, and lower volatility than growth stocks. Money managers buy value stocks because they believe there is an underlying value that the market has not yet discovered. Conversely, growth stocks are purchased with the hope that future growth will increase market prices. Since value and growth refer to two major investing styles, one typically outperforms the other during different market conditions. Therefore, both should be included in a diversified portfolio.

The third way to divide investments is among sectors. Money managers may think that a particular sector, such as

Nevertheless, many investors have found success by hiring money managers who are independent from their investment consultants. The clients, along with their consultants, are then able to choose from myriad stock pickers with various goals and benchmarks.

The Investment Consultant's Role

There are many investment professionals whose monetary incentive is to sell a product, such as a mutual fund. Their means of compensation, however, may lead to biased

of a team of advisors whose sole purpose is to help the client. A qualified investment consultant understands the delicate balancing act of maintaining a fair and adequate income stream for the income beneficiaries, while preserving the bulk of the trust for future beneficiaries. Furthermore, the consultant can set a Statement of Investment Policy for the trust to accomplish both needs and will typically use non-affiliated, independent money managers to put that statement in motion.

Portfolio optimization is another reason to use an investment consultant. Because once a goal is defined – for example, 8.0 percent average annual returns after taxes – the next step is to achieve that goal with the least amount of risk. The consultant should be able to offer a sophisticated understanding of asset allocation and risk management to evaluate the tradeoffs between risk and return. This knowledge should allow the trustee to successfully implement the trust's investment policy to the satisfaction of the grantor, income beneficiaries, and future beneficiaries.



consumer goods or health care, will outperform the market. In such instances, they will make sector bets by overweighting the portfolio's assets in those sectors to achieve greater performance while keeping those allocations reasonable in size.

The final way to diversify a portfolio is across money managers. Of course, the best ones should be used, which can be easier said than done.

recommendations. An alternative is for the trustee to consider a consultant whose job is to provide advice for a fee. This independent investment consultant should be able to clearly define, establish, and implement the investment goals and strategy of a trust and provide a vital layer of objectivity.

Ideally, in the arena of trust and estate planning, an investment consultant is, along with a CPA and attorney, part

The TRU permits grantors of trusts to take advantage of asset allocation and portfolio diversification to produce larger legacies for multiple generations. And an investment consultant can work with the trustee to help make sure that the grantor's long-term plans are not upset by the fickle markets.