

# VIGIL Strategies

Taking you where you want to be

## For Good Measure

My 5th grade son was recently working on a homework problem involving measurements. He determined that a million 6 inch pencils laid end to end would cover the distance from Milwaukee to Chicago. He determined that a billion such pencils would circle the earth nearly 4 times.

As I was helping my son with his homework, it occurred to me that we learn proper frameworks for measuring most things from very early on. Distance, length, time and weight measurements become almost second nature to us. While less empirically exact, we also develop ideas about how to measure value. Most of us can probably agree that gas at \$3.00 per gallon is “too expensive.” I am sure at least some agree with me that bottled water at \$1.50 and canned air at \$10 are “way too expensive.” We have an easy – and fairly accurate – sense of whether what we are receiving is worth what we are paying.

Earlier that day I had been involved in a local non-profit group’s discussion of the appropriate mechanism for measuring investment returns on their endowment fund. As I reflected on that discussion in relation to

all the lessons we learn from early in life about measurements and measurements of value, it struck me how relatively inadequately prepared we are to measure investment returns and to measure the value of assistance we might receive in that area.

This particular group’s investment goal, which should lead us to an acceptable form of measuring results, was a standard, boilerplate investment policy statement – to exceed inflation by 5-6% per year with excessive risk to principal. But is that really a valid basis of measurement? When anyone is looking at their portfolio’s performance over the 1, 3 or 5 years, does *anyone* calculate their return and then compare that return to the Consumer Price Index over that time? In 2002, the Consumer Price Index return was +1.6% for the year. The S&P 500 return was about -23% that year. If you were in an investment that was properly comparable to the S&P 500 and you lost 15% in 2002, was that HORRIBLE return because your return was 16.6% less than inflation? Of course not. Actually, that would have been OUTSTANDING return because you should have lost 23% with the kind of investment you had and you only lost 15%.

This is not meant to pick on this group. That kind of statement about the basis for performance measurement exists – and is equally objectionable for the exact same reasons – in many boilerplate investment policy statements circulating in the marketplace today. Instead, the proper measurement of investment return involves:

1. Proper calculation of total portfolio investment return – Often more difficult than it sounds or than it should be, this takes the total value of your portfolio at

the beginning, adjusts it for when and how much you have added or took out, and calculates the total return you have achieved to bring the value to what it is today. While many places are eager to tout returns of investments within a portfolio on an individual basis (often to distract you from the reality of the overall return), the fact is that all portfolios have some good and some bad. You need to accurately measure how you have done on an *overall* basis, taking the good with the bad.

2. Comparison of that return against the “market” – The “market” should be measured in relation to how your account is invested; U.S. large cap stocks should be measured against the S&P 500, bonds should be measured against an appropriate bond index and international stocks measured against an international stock index. If stocks have experienced losses and you are invested in stocks, you will probably have a loss as well. That does not mean your performance is bad performance, however, just because you have experienced a loss. If the “market” has lost 23% and you have only lost 15%, you have actually done quite well. However, if the market has only lost 3% and you have lost 15%, you have done poorly.



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## President's Message

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Once you have the proper return for your portfolio and the proper measurement of the market's return, it is fairly easy to determine how you have really done. This is where the inexactitude of measuring "value" comes in. Studies have shown that on average, individual, inexperienced investors, left to their own devices, achieve about 40% of the return they should actually achieve because of mistakes, overestimating their skills, paying too many expenses they are not aware of and/or trying to "time" the markets. So if you pay nothing for professional advice (at least nothing of which you are blatantly aware) but only get 40% of the return you should get (i.e., in a year that the market gains 10%, your portfolio gains only 4% on

an overall basis), is that a good value?

A body of evidence being developed by Standard and Poors demonstrates that 50 to 70% of professional investors don't achieve returns equal to the "market." Against that backdrop, professional advisors who achieve returns that exceed the market are extremely valuable. But yet one of the questions that carries significant weight in most measurements of "value" of investment advice is "what is the cost?" Which has more value: advice that "costs" less but achieves results worse than the market or advice that costs more and achieves results greater than the market?

You don't measure investment returns based solely upon your return number. *You need to measure that return in the context of a proper measurement of the market's return over that*

*same period.* And you don't measure the value of investment advice based upon its cost. *You measure that value based upon the returns you receive relative to the market in exchange for the cost of that advice.*


Proper measurement in the area of assessing investment returns is not all that much more complicated than all of the other kinds of measurements we are introduced to from an early age. We simply are not as schooled in it. But the proper tools are fairly easily acquired and are key to accurate measurement of results and value. 



Tom Batterman  
President

Vigil Trust & Financial Advocacy

## Save the Date! Vigil Open House Around the Corner

Mark your calendars as the Vigil Holiday Open House has been set. Grab a friend and join us Thursday, December 15 from 3:00-6:00 for an afternoon of hors d'oeuvres, desserts, drinks, and lively conversation. Current clients can enjoy catching up and getting in the holiday spirit. If you've always wondered about what we do, take this opportunity to come in and chat with us in an informal setting. You'll have the opportunity to meet with all of our staff members and tour our office. While reservations are not required, they are appreciated as it will help us plan. Call 800-950-8110/848-8110 for more information or to reserve your spot. Hope to see you there! 

## The Social Security "Supertax" Taxation Trap


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If you are in a situation where your MAGI is below \$50,000, you need to be particularly careful not to create additional income for yourself that triggers or increases the SSS. In particular, be careful with your retirement plan/IRA distributions and capital gains. In our experience, most people with this kind of income realize that they will pay tax on it but fail to recognize that this income may cause them to pay additional tax on their current Social Security benefits. As a result the effective tax rate on this additional income is actually much higher than you think.

If you think the SSS might affect you in 2005, run a sample calculation of your MAGI. If you have capital gains you might incur yet this year or retirement plan distributions you are thinking you might take yet this year, this calculation will help you determine the SSS ramifications of that additional income. If you have already incurred gains or taken too much out of

retirement plans such that the SSS is now affecting you, scramble to take capital losses to offset the gains before year end to reduce your MAGI and your SSS. If you can't do that, use other tax minimization strategies such as doubling up on itemized deductions to reduce your taxes this year – and be aware of the issue next year.

Remember that the SSS we are talking here relates to the taxation of your Social Security benefits, NOT your *eligibility* for those benefits. Eligibility rules, such as how much earned income you can have and still be eligible for Social Security, is a whole different issue. We are talking here about controlling how much tax you are paying on your Social Security benefits once you are eligible and have actually received those benefits.

Do not hesitate to contact us if you require assistance in assessing the implications of the SSS in your particular situation. 

## Disciplined Portfolio Management Essential for Portfolio Well Being

Risk is a fact of life for any investor. Stocks plunge. Bear markets linger. There's even risk in doing nothing. Due to inflation, \$100 left in the bank earning no interest will be worth about \$55 in 20 years if inflation averages 4% annually.

To outpace inflation, you have to assume a certain amount of risk in your investment portfolio. If you minimize your exposure to the volatility that comes with investing in the stock market, then you have to accept lower returns.

The past eight years has given investors a strong lesson in risk. During the late 1990s, most investors thought they had a great tolerance for volatility. Yet, after a three year bear market, some of those same investors changed their minds. They decided they had little to no risk tolerance and pulled out of the stocks that had served them well just in time to miss out on the market's gain.

Stay in the market. Stay the course. Over the last 20 years, the stock market has averaged a 12% annual return. Interestingly though, according to a study by Dalbar Financial, mutual fund investors earned only about 4% and Vanguard reports that 401K participants earned about 6%. Why would this be?

It's unpleasant to contemplate, but most individual investors are not able to capture market returns. This is because individual investors have a tendency to trade more often than they should and each trade typically costs them in terms of commissions paid to their advisor or broker. Individual investors also have a lousy sense of timing, as they often pull out of the market during a downturn and miss out on the corresponding rally that follows. Similarly, investors chase the hot sector, or best performing market segment but by then the market has turned in another direction. Also, there is the issue of stubborn investors that either fail to or refuse to recognize and sell poor investments.


**Asset Allocation-** In a landmark study of pension plans, it was discovered that the asset allocation decisions (the percentage of a portfolio to be invested in stocks/bonds/cash) accounted for 93% of the variability of returns. Asset allocation is the single most important

decision an investor makes, and should be based on three factors; your risk tolerance, the number of years before you begin taking distributions from the portfolio; and the rate of return required for you to meet your financial goals.

Your asset allocation should change only when one of these three factors change. Do not, we repeat, do not let geopolitical events, market moves, or economic forecasts drive your asset allocation decision.

**Diversification-**Diversification among the major asset categories (stocks, bonds, and money market investments) can help reduce market risk, inflation risk, and liquidity risk. Diversification within the major asset categories (international and domestic stocks, or large and small cap stocks) or fixed-income products can help further reduce market, inflation, and business risk. Recommending the right mix is the job of your financial advocate.

**Rebalancing-** Review your actual asset allocation at a minimum of least once a year, and rebalance to the targets you developed. For example, if you selected a 50% stock and 50% bond asset allocation in the beginning of the year, your asset allocation is likely to be something quite different by the end of the year, given market returns. Take the time to readjust to your target allocation so that you are able to capture gains.

Your financial advocate or you should also rebalance among the different mutual funds that you own. Are you holding much more of a certain type of investment than originally intended? If so, it's time to sell those mutual funds that weigh too heavily in your portfolio and purchase additional shares of those that have become anemic. Failing to exercise this type of discipline is much like failing to exercise. You might get away with it for a couple of years without noticeable harm but after a while those extra pounds (or smaller dollar amounts) add up. As many middle age people will tell you, once you've let the exercise and eating right go it is very difficult if not impossible to ever get back to where you were. The same holds true with investing. 

## CPA Marcie Thompson Joins Vigil Staff


You've heard the saying that, "a fool and his money are soon parted." Well, in accounting circles it's often said that, "a fool and his money are soon audited." At Vigil we work



diligently to keep our clients up to date on tax laws and changes so that they make the very best tax decisions.

For this reason, we are pleased to announce that Vigil clients now have another resource to turn to. Marcie Thompson, an experienced certified public accountant, has recently joined the staff of Vigil. Marcie will be working with new and existing clients as a Financial Advocate and Trust Officer. Do you have tax related investment questions? Give Marcie a call and introduce yourself. She would be happy to be of assistance.

Marcie lives in Wausau with her husband, Kenny, fifteen year old daughter Chelsey, and son Dawson, age 13. Prior to coming to Vigil, Marcie worked at a local accounting firm. Marcie enjoys spending time with family and friends and working on home improvement projects.

With the addition of Marcie, Vigil now boasts two attorneys and a certified public accountant on staff. As a fee-only financial services and independent trust company we are proud to be able to bring you quality investment advice by Financial Advocates who have the met the highest levels of training and experience. 





Vigil Trust & Financial Advocacy  
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Visit us at  
[www.trustvigil.com](http://www.trustvigil.com)

Call us at  
**800-950-8110**  
**715-848-8110**

## The Social Security “Supertax” Taxation Trap

If you are a recipient of Social Security and as the “sun is getting ready to set” in terms of fixing your income tax liability for 2005, be mindful of what we like to call the “Social Security Supertax” (SSS).

Social Security is quite unusual from an income tax standpoint. If your “modified adjusted gross income” (MAGI) which is your adjusted gross income plus some adjustments (including half of the Social Security benefits you have received), is under a certain level (\$25,000 for single persons and \$32,000 for married persons), you pay no income tax at all on your Social Security – it is TAX FREE! On the other hand, if your MAGI is over \$34,000/44,000, you pay tax on as much as 85% of your Social Security.

If your MAGI is always well over \$44,000, this concern does not affect you; you will always pay tax on 85% of your Social Security no matter what you do. But in other cases, increases in earned income may carry you over the threshold where you have to start paying tax or will increase the amount of tax you are paying on your Social Security. In these cases, additional dollars of income cause tax on that income plus additional tax on existing Social Security income – the Social Security Supertax!

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