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Vigil Trust & Financial Advocacy

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Financial Questions?

Do you have a financial question you would like a confidential answer to? Visit www.trustvigil.com and click on the “ask the expert” link on the bottom of the home page. One of our experts on staff will get back to you promptly with an answer. This is a no cost service we offer to help consumers who are looking for sound financial advice. So now when that question pops in your head you can email us right away.



Do you golf?

If the answer is “no” then this group will interest you! Heather has started a league for women who are interested in using those nice golf clubs that never or rarely get used.

If you are interested in joining email Heather Summers at hsummers@trustvigil.com or call her at 715-848-8110.



The Merrill Lynch Rule Beware the stockbroker bearing advice.

In a 2 to 1 ruling the U.S. Court of Appeals overturned the “Merrill Lynch Rule” that allowed brokers to charge asset-based fees.

Maybe you’re asking, “What is this?” The SEC adopted what is known in the financial industry as the “Merrill Lynch Rule.” While it has not been widely publicized, this rule is something that investors should have been made aware of. It allowed certain types of broker-dealers (the people who sell you stocks) to offer investment advice without being held to the same standards as fee-only planners, who must serve as fiduciaries and put the clients interest first. The rule allowed brokers who weren’t registered investment advisors from any obligation to relay that fact to their clients.

It is important for investors to understand the terms “fiduciary duty”, “suitability”, “investment advice” and “solely incidental” to order taking.

Fiduciary Duty vs. Suitable
The big difference here is how much the advisor is on the hook for bad advice. If I am a thirty-something single white male making \$50,000 per year and a huge risk tolerance, buying that new IPO may be suitable for me and still not be in my best interest. Under the Investment Advisor Act

of 1940, an investment adviser has the fiduciary obligation to act solely in a client’s best interests, or face a fiduciary breach lawsuit in a court of law. On the other hand, a broker dealer can have all sorts of conflicts of interest, and will only be raked over the coals if they treat you bad by the suitability standard – which is much harder to prove.



As the rule’s name implies, if a broker-dealer provides investment advice, which is solely incidental to the transaction, then the broker-dealer is exempt from the rule. The obvious question is why you would want “incidental advice?” There is no such thing as “incidental financial planning” just as there is no such thing as “incidental litigation” or “incidental surgery”. “Incidental financial planning” is incomplete financial planning and it does more harm than good. Either you have a financial advocate working as a fiduciary in your best interest or you are being sold by a salesperson.

So how does this sound?

“Mr. Client, I noticed that the price-to-earnings ratio of stock AAA is pretty high compared to TXU. Why don’t we dump your AAA and buy a bunch of TXU? While we’re at it, I get a bigger commission for XYZ fund than ABC fund. Let’s move you into XYZ.” During the transaction, the broker sells the shares for ½ of a penny less

than market price and buys new shares for ½ of a penny more than the market price, keeping a penny per share for himself – less commissions. What a deal, and although crude, it represents what Merrill and the other broker-dealers have been able to get away with for 8 years now.

Buyer Beware?

The rule was extremely biased toward big broker-dealer outfits (like Merrill Lynch) at the expense of investors and true fiduciaries. The big brokerage houses can sell you investments dressed up as investment advice while the mom and pop financial planners have to qualify everything they say, and moderate their emotional language and even refrain from using testimonials. How can they compete if they don’t even live by the same rulebook?

Now all these broker-dealer guys (like your Merrill Lynch guy) will have to register as investment advisors, and play on the same field with the same rules as everyone else.

You should ask and understand if there are conflicts of interest. Your brokers’ real allegiance is to his firm rather than you. Hopefully the SEC will adopt the decision of the court and not take the case to the next level. There is an estimated \$300 billion in fee based accounts at brokerage firms this ruling will affect.

At Vigil Trust and Financial Advocacy you never have to question what motivates our recommendations. We are fiduciaries paid only by you and don’t accept commissions or incentives. We provide conflict free financial planning advice to serve your best interests.

Vigil Trust & Financial Advocacy
Financial Advocates
510 North 17th Ave., Suite C
Wausau, WI 54401
ADDRESS SERVICE REQUESTED

Inside...

- 2 Annuities - The Real Story
- 3 Capital Gains or Capital Punishment?
- 3 Day Trader or Gambler?
- 4 Financial Questions?
- 4 Do you golf?

Annuities - The Real Story

Life insurance agents and securities brokers often foist annuities upon their clients without properly explaining them or ensuring that the annuities fit the clients' needs. Why? Because annuities typically pay handsome commissions to your sales person (more on this later). Again and again I hear people telling me, "I wish I would have never bought this annuity." Unfortunately for most, they were part of a sales process that in many cases wasn't in their best interest. Once they realized what they really bought it was too late.

An annuity, if you are not familiar with it, is a contract between you and an insurance company. There are several types of annuities, but the bulk of them are either fixed, which means there is a guaranteed rate of return, or variable, which have a return tied to the performance of the underlying investments. The term "annuity" literally means "annual payment of allowance or income." Basically someone pays a premium and later they receive monthly income. The amount you receive, usually greater than the premiums you paid in. The big problem is inflation. While the money you pay in premiums is generally less than you're guaranteed to receive, when you adjust for inflation, you could be losing out.

So why do people keep buying these? They hear terms like:

- Guaranteed Income for life.
- No Exposure to the Stock Market
- Added Security
- Death Benefit protection

Most people at some point in time worry about if they will have enough income in their retirement years. Fear starts to creep in about the uncertainty of the stock market and what will happen in the future.

That is why it is no surprise to me that the fear of outliving our investments makes it easy prey for annuity sales people. So if annuities are such a bad deal, why do people keep on buying them even though financial planners don't care for them? One of the major reasons is that annuities have nice sales commissions so they get pushed on people a lot. Typical commissions range from 5 to 5.5 percent of the money invested, with some contracts paying up to 14 percent commissions. It is the need to recover the money paid to the salesperson for his commission that generally contribute to the high surrender fees and typically lock up an investor's money for at least seven to ten years. It is alarming that the advent of home equity lines of credit makes your home more liquid than your annuity and it's a wonder to me why someone would make an investment that you are required to own for life or you are forced to pay a penalty-up to 25% or higher- on YOUR money when you try to cash it out.

Another reason is the numbers look very impressive. While virtually ever other investment reports net flows the annuity industry reports on its gross sales. It's an important distinction because many of those sales are actually assets that have been moved from one fund to another in what is called a 1035 exchange. This is a provision in the tax code that allows people to take money from one tax-deferred investment and put it in another without having to pay taxes or penalties.

Understand the tax impact. While annuities may be good in certain situations transferring wealth is not one of them. Annuities are part of your estate, so if your estate value is above the threshold,



as much as 47% of your annuity could be lost to taxes. There are other options, such as appropriately established life insurance policy that can pass the proceeds tax-free to your heirs, outside the estate.

Compounding the problem for annuities, all the gains inside an inherited annuity will be taxed at the heirs' ordinary income tax rate, which can be quite significant in a tax deferred annuity. Compare this to selling your annuity and buying stocks, bonds or mutual funds. Because of the step-up in cost-basis these investments can pass onto your heirs without passing the tax burden for gains along with them.

The ability to sell your annuities may be met with such relief that the immediate reaction is to cash out but every situation is unique and you should consult with a fiduciary before making a decision. If you are concerned that the person you are working with is more concerned about commission and is not a fee-only planner it's time to look for someone who is looking out for your best interest not theirs. ✓

Capital Gains or Capital Punishment?

Nobody likes to write Uncle Sam a big check. That's why mutual fund investors not only have to worry about management fees and poor performance but also the hidden aspect of their portfolio that can wind up being just as costly: capital-gains taxes.

During tax season, mutual fund investors become confused. Why do they have to pay taxes on a fund that had a losing year or worst yet taxes on a fund that didn't perform as well as the market?

By law, mutual funds must declare distributions each year. These distributions represent a profit the fund made when selling securities. Each year the fund pays out these gains to the shareholders in the form of income dividends and/or capital gains. These payouts are taxed at standard capital-gains rates, so the trick for the mutual fund manager is to balance the profits from selling winning stocks with offsetting losses of those that haven't performed so well. That way the average investor doesn't get hit with a large tax bill.



But even shareholders who invested in a brokerage account, for example, have been able to forget about capital gains over the last few years. That's changing-quickly. Mutual funds are allowed to stockpile losses and carry them forward to the next year. In 2002 and 2003 the average mutual fund paid out between 16 and 17 cents per share. Since then, the stock market has been on a roll not including earlier this quarter mind you. This means all the losses have pretty much dried up. The average capital gains distribution skyrocketed to \$1.09 a share in 2006. You need to keep in mind that after expenses that taxes are the single biggest contributor to a funds returns.

A better way to manage your investment taxes might be to minimize taxable gains in the first place. For example you could keep income generating investments in your tax-favored retirement and growth investments on your taxable account. If your portfolio is large enough you might buy individual stocks instead of mutual funds because then you control when to sell the stocks.

Tax efficiency and good returns can be a powerful combination. Keep in mind that if you are investing in a tax deferred account like your 401(k) at work or an IRA, Uncle Sam will have to wait until you start taking money from these accounts. ✓

Day Trader or Gambler?

I recently had a friend tell me that they are really into day trading right now and that several of his friends have pooled their money and make trades. I asked him how he was doing and he said, "Great, I make money everyday and never loose on a trade." I had to chuckle inside because I suspect if he would have told me he goes to the casino everyday and I would have asked him the same question his reply would have been, "Great, I win every time I go."

Can anyone be a constant winner all the time or make huge profits on day trading? If he had one year and \$50,000 for day trading and the same amount invested prudently over the



same amount of time with a financial advocate I wonder which investment strategy would be the winner. I'm going to place my bet on working with a financial advocate with my money verses trying to time the markets and gamble it away.

I'm thinking things aren't going so well day trading. Last time I talked with him he was thinking he was going to have to get a part-time job to be able fund his retirement because his investments weren't doing as well as when he retired.

I guess I won the bet!