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What to do when a fund manager leaves

Portfolio managers (PMs) can play a key role in the overall success of your investment plan. So what should you do when a fund manager leaves?

You might be tempted to sell a fund undergoing a PM change, but it pays to look before you leap. You and your financial advisor must decide whether the fund can likely continue to deliver the kind of performance that originally attracted you to it. Even though the decision is ultimately more art than science, consider the answers to these questions.

Evaluating a PM's chance for success

Several factors can adversely affect a portfolio manager's (PM's) track record — and not all are reasons for concern. Sometimes a track record might be "poor" just because his or her investment style is temporarily out of favor.

For example, during the Internet mania of the late 1990s, most value-oriented PMs lagged the broader market simply because it was a time when investors chased growth and spurned value. However, value investing returned with a vengeance in 2000, when the dot-com bubble burst. So, if a newly hired PM has proven his or her mettle over a long period of time — preferably, a decade or more — but has lagged lately, you may still have grounds for optimism.

It's also important to look at how the size of a fund may affect a new PM's performance. For instance, a small-cap growth manager who enjoyed great success overseeing $50 million in assets might struggle when taking over a $1 billion fund. If you purchased your fund long ago, and it has grown significantly since then, a managerial change may be a good time to revisit whether a smaller and nimbler substitute is available.

Was the PM a star?

You and your advisor need to determine how important the PM was to the fund. For example, when famed manager Peter Lynch stepped down from the helm of Fidelity's Magellan Fund in May 1990, it was hard to imagine anyone else duplicating Lynch's stock-picking prowess, which produced an average annual return of almost 30% during his 13-year tenure. That said, investors who remained with Magellan saw it continue to outperform the market — albeit by much smaller margins — under its next two PMs.

At the opposite end of the spectrum, you have less cause for worry when your index fund undergoes a PM change. With a passive, systematic strategy such as indexing, a new PM can be expected to more easily pick up where the previous PM left off.

What's the management structure?

Another point to consider is whether your fund's former PM was working independently or as part of a team. While a team approach isn't necessarily better, the departure of one co-manager in a group of, say, five is less likely to result in significant changes in performance and strategy than when a "lone wolf" manager departs.

In addition, consider how the fund company manages the transition. Although sudden PM changes are

the rule rather than the exception in the world of mutual funds, it's a plus if the outgoing PM intends to work with the fund's new PM to help smooth the transition.

Has the management style drastically changed?

A sudden shift in management style coinciding with a new PM should raise red flags. First, it might indicate turmoil or disorganization at the fund company, especially if it's one in a series of recent PM changes.

Second, no matter how capable a fund's new PM is, the investment may not be the right option for you if it no longer suits your asset allocation needs. For example, if the large-cap growth fund you bought five years ago has morphed into a large-cap value fund, you may find your portfolio overexposed to certain holdings and underexposed to other parts of the market.

Is the PM learning on the job?

You may face another problem when a fund's management style remains the same but represents a new area of focus for the incoming PM. If, for instance, an international stock fund's new PM's previous experience was limited to domestic stock funds, you can expect a learning curve.

In this situation, you're likely to see higher turnover and more index-like performance for a while, because the tendency in such situations is for a new PM to bring the fund's positioning more in line with its benchmark while getting up to speed on a new group of securities.

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In fact, while the new PM might have some experience with funds like yours, it's relatively rare to land a PM with a long, successful tenure at a fund with a similar strategy. Despite this obstacle, replacements may turn out to be good long-term managers in their own right.

Analyze before you act

Keep in mind that, when you sell a fund, it's important to consider any applicable withdrawal charges and know that tax liability can result from the sale. For this reason, and because it's hard to quickly determine the impact of a PM change, consider giving the new PM time to prove him- or herself. (See "Evaluating a PM's chance for success" on page 2.) But don't ignore a PM's departure. Discuss the potential implications with your advisor, and formulate a plan for how to respond. ■

Exemption portability not all it's cracked up to be

Create a credit shelter trust as an alternative

If you're married and concerned about estate planning, you've probably heard about how the 2010 Tax Relief act provided for the "portability" of the estate tax exemption. Portability allows married couples to take advantage of their combined exemptions without the need for complex estate planning. But portability isn't all it's cracked up to be. Creating a credit shelter trust often is a better alternative.

Portability in action

Under the Tax Relief act, portability is available only through 2012, though legislation has been proposed to make it permanent. (Check with your tax advisor for the latest information.)

If one spouse dies while portability is in effect and his or her estate tax exemption isn't entirely used at death, the estate can permit the surviving spouse to use the deceased spouse's remaining exemption. The surviving spouse can use that amount, in addition to his or her own exemption, to make tax-free transfers during life or at death.

But portability isn't as simple as it may first appear. For one thing, portability isn't automatic. The executor of the deceased spouse's estate must make an election on a timely filed estate tax return — even if a return wouldn't otherwise be required. For another, special rules apply to surviving spouses who are predeceased by more than one spouse.

Also, if your estate plan includes bequests to grandchildren, keep in mind that the generation-skipping transfer tax exemption isn't covered by the portability provision.

An alternative: The credit shelter trust

While portability has its share of complexities, it's still simpler than a credit shelter trust (sometimes referred to as a "bypass" trust). Nevertheless, creating such a trust can be a better alternative. Why?

First, for a couple to take advantage of portability, one spouse must die while the provision is in effect — and the surviving spouse must also use all of the remaining exemption while the provision is in effect. Otherwise, it will be lost. Even if portability is "made permanent," it possibly could be repealed at some point in the future. So married couples can't necessarily rely on portability being available when they need it.

Creating a credit shelter trust can effectively preserve both spouses' exemptions regardless of whether portability is available. But even while portability is available, a credit shelter trust offers a major advantage: It can protect future appreciation on the trust's assets from estate taxes.

How the trust works

Without portability, it's easy for married couples to essentially "lose" the exemption of the first spouse to die. Here's how: Jim and Judy each have assets equal to the estate tax exemption amount and have wills that allow their assets to pass to the surviving spouse. Let's say Jim dies first. His assets transfer estate-tax-free to Judy, thanks to the unlimited marital deduction.

However, the assets eventually will be included in Judy's estate and potentially taxed after her death. If on her death Judy has assets equal to twice her exemption, half of her estate will be subject to estate tax. A credit shelter trust can protect the exemption of the first spouse to die. On Jim's death, the trust can be funded with the maximum amount that can be sheltered from tax using Jim's available estate tax exemption. The trust then pays income, and can also pay principal, to Judy for the remainder of her life.

Because Judy never gains control of the trust assets, they bypass her estate and go to their children (or other designated beneficiaries) estate-tax-free on her death. Neither spouse's exemption is lost because Jim's exemption protects the assets in the trust and, when Judy dies, her exemption covers the remaining assets.

Now let's imagine that the assets in the trust appreciate during Judy's remaining lifetime, growing more per year than her withdrawals. This appreciation will also pass to the children estate-tax-free. Jim's exemption protects all of the credit shelter trust's assets from estate taxes, regardless of how much they grow beyond his exemption amount.

Right for you?

Credit shelter trusts not only will allow assets equal to the unused exemption itself to escape estate tax, but also will shield future growth on those funds from estate tax.

Your estate planning advisor can help you determine whether a credit shelter trust is right for your specific circumstances. Or, if one already is part of your estate plan, review it with your advisor to ensure that, in light of any estate tax law changes, it will still achieve your goals. ■

Money doesn't grow on trees

Help your children acquire a saving and investing mindset

If your children are growing up in relative affluence, it might be tough to sell them on the importance of saving and investing. Yet there's no time like the present to promote healthy attitudes about money. Children who are insulated from financial matters can have a rude awakening once they're on their own.

Instill a respect for money

The most essential money lesson you can impart to your children is that money is a scarce resource to be carefully managed. When children have access to money every time they want it, they can take it for granted.

Consider having your kids earn their own money, such as by performing chores around the house, and then make them responsible for paying some of their expenses. This helps instill the idea of earning and saving as well as the importance of balancing needs and wants.

Show them the power of compounding

Showing the power of compounding can help your children understand why it's important to start investing sooner rather than later. This discussion can yield one of those "wow" moments, when a child finally grasps an abstract point in a concrete way.

One useful approach is to compare the results of two hypothetical investors, one of whom waits much longer than the other to begin saving for retirement. It's a sobering moment when you realize just how much more a younger investor can accumulate than one who gets started later. Ask your financial advisor for appropriate resources to help you communicate this point effectively.

Build an age-appropriate portfolio

When your children have learned the basics of saving and investing, let them help build their portfolios. While some kids will enjoy analyzing individual stocks, others may prefer buying mutual funds because it can be easier. It's also worthwhile for young people to understand the basics of other asset classes and that cash, bonds and even commodities can be used to diversify a portfolio and dampen volatility for investors with more conservative leanings.

For help in selecting the right mutual funds, your kids can benefit from the numerous fund screeners available on the Internet, and they might even enjoy doing this research themselves. The premium fund screener offered by investment research company Morningstar allows searching for socially responsible funds and funds with automatic investment plans, which are suitable for the repeated small investments that may be appropriate for a young person getting started with investing.

Give them the right tools

You've worked hard to build your wealth and want to instill in your children the understanding that money doesn't simply grow on trees. By beginning to teach them at a young age about respecting and saving money and, as they get older, about building an investment portfolio, you'll give your kids the tools to successfully manage their money as adults. ■

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What does 2012 hold for your personal financial standing?

2011 will likely be remembered at least in part for wildly fluctuating financial markets, high unemployment and congressional inaction. This economic uncertainty may have directly affected your personal financial status. The new year is a good time to reassess your personal financial standing for 2012.

Net worth statement

Any assessment of your personal finances should begin with your net worth. To calculate this important figure, you need to create a net worth statement. Having this information on hand will help you see where your finances stand and whether you're in danger of straying from your goals.

What is your net worth? Simply put, it's the value of what you *own*, minus what you *owe*. Calculate your net worth by adding up all of your assets, including cash, retirement funds, business interests, investment account balances, personal property and real estate.

Then subtract your liabilities, including mortgages, other loans and outstanding lines of credit, credit card balances, and taxes due. What's left is your net worth. Seeing this number on a page (or computer screen) can really put in perspective just how you're spending your money and whether you might be able to do more to grow your savings.

Insurance coverage

Another key area to reconsider is your insurance coverage. Many people have seen their home values decrease, which may call for a downward adjustment in homeowners coverage.

Life insurance is another critical financial issue to assess. Do you have enough coverage? Too much? Ask your insurance professional to help you determine the right amount of coverage. If your personal cash flow is particularly slow, you might even consider withdrawing some of the cash value of your policy or using it to cover premium payments.

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Depending on your coverage type and its terms, you may be able to take tax-free loans against the policy's cash value. Typically, current loan payments aren't required; the principal and all accrued interest are deducted from the death benefit, reducing your death benefit and cash value unless repaid.

Employer-provided benefits

Once settled into a job, many people lose sight of their employer-provided benefits. Check in on them. You might, for example, want to change a beneficiary for your employer-sponsored retirement plan, such as a 401(k). Also evaluate your deferral amount to ensure you're putting away enough.

Do the same for contributions to your Flexible Spending Account or Health Savings Account (if you have them). Remember that these contributions are pretax, so they don't reduce your take-home pay by the full amount of the contribution.

What's in store for 2012?

Economic uncertainty may persist into 2012 and even beyond. Your wealth management plan stands a better chance of weathering the storm if you take the time now to review and update it. Discuss your options with your financial advisor before taking any action. ■

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By working with our experienced team of advisors, you will benefit from the independent and objective perspective necessary to make your financial vision a reality.

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Crystal Garner
V.P. – Relationship Mgmt., Senior Financial Advisor
Crystal Garner is an investment advisor and veteran member of the team and is responsible for ensuring clients receive the highest level of personal service. In addition to assisting clients with their multi-faceted needs, she also manages the daily operations of the firm.

Shena Simmons
V.P. – Operations – Senior Financial Advisor
Shena serves as an investment advisor for the firm and utilizes her dual background in finance and marketing in responsibilities ranging from financial planning to directing the firm's marketing efforts.

J.L. Hurt IV
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J.L. serves as a research analyst and portfolio manager for the firm. In addition to assisting clients with the many facets of financial planning, he is also responsible for the rebalancing of client portfolios and analysis of securities and separate account managers.

Eric Faber
Financial Advisor & Business Developer
Eric is an investment advisor responsible for helping clients establish and achieve their long-term financial goals through comprehensive financial planning.

Stephanie Galvin
Financial Consultant & Operations Analyst
Stephanie serves as a financial consultant and operations analyst for the firm. She is responsible for quarterly reporting and billing, maintaining the firm's portfolio management system, and ensuring the accuracy of account data. Stephanie also assists with financial planning, portfolio analysis and marketing.

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