

The Elusive Sure Thing

As we began 2010, it seemed there were three sure things: The price of gold would rise, bond yields would rise and inflation would show up uninvited. The year began with gold at \$1,121 and the 10-year Treasury note yielding 3.82 percent.

At the end of the first quarter, gold is at \$1,113, and the yield on the 10-year Treasury is 3.83 percent (as of 03/31/10). The U.S. Consumer Price Index, which tracks inflation, rose just 0.3 percent and 0 percent in January and February, respectively.

Despite the economic and political issues (domestic and international) that we have faced so far this year, equity markets around the globe have turned in solid performances. Unfortunately, again this quarter, so many investors made the same mistake they did in 2009: They poured money into short-term cash equivalents such as money market funds and savings accounts. In March, there was more than \$8 trillion in cash equivalents with nearly \$3 trillion in money market funds.

In their fixed income allocation, it has been difficult for many investors to take at least some term risk. This is frustrating because the yield curve has been very steep, providing a large risk premium.

Investors have been reluctant to extend maturities beyond the very shortest term because the conventional wisdom is that interest rates are sure to rise. This fear has caused them to try to insulate themselves from the negative impact of rising rates.

At some point this year, the Federal Reserve may begin raising its target for short-term rates to stay ahead of inflationary pressures. However, investors fail to recognize that given the steep yield curve, it is quite possible they could actually be exposing themselves to the greatest risk by staying short. That's because that is where rates could rise the most, and those investors could miss the opportunity to capture the better rates that currently exist not much further out on the yield curve.

While a Fed tightening will certainly lead to a rise in short-term rates (driving down the prices of short-term bonds), that doesn't mean that long-term rates will have to rise. In fact, if the Fed raises short-term rates more than expected, long-term rates might actually fall. The reason: An unexpectedly large increase would be perceived as a tightening of monetary policy, which has positive implications for longer-term bonds.

What is really unfortunate is that recent history provides an example of this very point, evidence that investors either don't know their history or they don't learn from their mistakes. From 2004–2007, as the Fed was tightening monetary policy, one-month T-bill rates rose from less than 1 percent to more than 5 percent. During this period, one-year Treasury bills returned 3.3 percent per year, and five-year Treasury notes returned 4.2 percent per year. Thus, despite a sharp rise in rates, long-term bonds were the best place to be.

Given that there is no evidence suggesting that professionals have the ability to forecast interest rates, it seems prudent for investors with fixed income allocations to at least consider extending maturities and

earn the term premium within the context of their Investment Policy Statement. As research has shown, for the best estimate of tomorrow's yield curve, one should look to the yield curve today.

Four Estate Planning Steps to Consider

By Chris Erblich

Review and Update Existing Estate Planning Documents — It is essential to have core estate planning documents in place (living will and health care power of attorney, financial durable power of attorney, will and revocable trust). Estate planning is a journey rather than a one-time destination, meaning these documents should be reviewed every few years. Laws change, family situations change and attitudes toward wealth and charity change. Estate planning documents should change to keep pace.

Review Beneficiary Designations — A beneficiary designation — such as a “transfer on death” designation on a savings account, or a beneficiary named on a life insurance policy or retirement plan account — controls where these assets pass on death, **regardless of where an individual's will or revocable trust directs assets to pass**. It is critical that beneficiary designations be properly coordinated with the overall estate plan.

Implement a Revocable Trust Rather Than a Will — Most people would identify a will as the document that controls where an individual's assets pass on death. A revocable trust (also called a living trust) is a “will substitute” with several advantages. With a properly funded revocable trust, an individual may avoid the need to probate assets upon death (a slow, costly and public process) and may plan for periods of lifetime incapacity.

Pass Assets to Future Generations in Trust Rather Than Outright — An individual's will or revocable trust commonly directs assets to be distributed outright to children or grandchildren at a certain age, such as 25 or 30. Outright distributions to beneficiaries can have significant drawbacks. Assets distributed outright to a beneficiary may be exposed to a beneficiary's creditors, divorce claims and estate taxes. If assets are instead held for a beneficiary in a lifetime trust, it may be possible to avoid creditor and divorce claims and also to minimize estate taxes, all while maintaining flexibility for the beneficiary.

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