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QUARTERLY PERSPECTIVE

DVI
DAVID VAUGHAN INVESTMENTS

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A POTENTIAL GAME CHANGER

Will Williams *President*

"The **industry** needs to take a page from the organic food movement and get back to basics with simplicity and transparency," said Ashby Monk, the director of the Global Projects Center at Stanford University in a recent Institutional Investor article and the **industry** he was talking about was the financial services industry. We whole heartedly agree! A day doesn't go by in which we are faced with clients who have placed their hard earned money in complex investment structures in which, as Mr. Monk suggests, they "do not truly understand the fees, costs, risks and incentives being accepted either explicitly (external) or implicitly (internal)." Furthermore, "once people realize the true cost – and consequences – of opaque products, they will consume in a more sustainable manner."

Much of this article reinforces many of the concepts that have been incorporated into the Department of Labor's Re-Proposed Fiduciary Rule. Back in April 2015, the Department of Labor issued out proposed rulemaking that would apply a "fiduciary" standard to all individuals receiving compensation for providing individualized investment advice to Retirement Plan sponsors, Retirement Plan participants or IRA owners. They solicited feedback and input from the industry with the commentary period closing in late September of last year. This standard has been the cornerstone of the Investment Advisors Act of 1940, the U.S. federal law that was created to monitor and regulate investment advisory firms such as David Vaughan Investments. Registered Investment Advisers **must** act with the care, skill, prudence and diligence that a prudent person would exercise based upon the current facts and circumstances. The broker dealer community is up in arms as they have never had to apply this standard to their business practices. They operate under a suitability standard; are the recommendations being made simply suitable for the client based upon facts and circumstances? There are no conflict of interest or fee disclosures under this arrangement as their duty of loyalty is to their respective firm rather than to the client.

One can be exempt from this proposed new fiduciary rule with a best interest contract exemption signed by the client. This legally enforceable contract would include language such as 1) the firm and its adviser will provide advice in the client's best interest 2) that the firm has adopted policies and procedures designed to mitigate conflicts of interest and 3) the disclosure would include clear and prominent facts that may prevent the advisor from providing advice in the client's best interest such as hidden fees or back door payments.

Acting in your client's best interest and providing full disclosure on investment advisory expenses are both fundamental business practices here at DVI. We welcome the competitive landscape in which banks, broker dealers and insurance companies will be required to adopt similar best practices or disclose their cost structures and conflicts of interest through best interest contracts. The final rule was released on April 7, 2016 and will have an effective date for retirement plan service providers as of April 2017.

Jeff Huizenga, CFP® ChFC
Relationship Manager

ESTATE PLANNING CONSIDERATIONS FOR MARRIED COUPLES

Married couples have had a new estate planning choice the past few years. In 2013 Congress passed the American Tax Payer Relief Act of 2012 (ATRA) that fixed the federal estate tax exemption amount at $5 million per person and is adjusted for inflation. For 2016, the exemption amount is $5.45 million. An additional provision added if one spouse doesn't use their full federal estate tax exemption, the surviving spouse can inherit the unused portion. This created "portability" of the federal estate tax exemption upon the death of the first spouse. Given the availability of "portability," a married couple truly has a combined, inflation adjusted, federal estate tax exemption of $10.9 million. Given this significant change in the law, the estate plan of every married couple needs to be re-evaluated.

Under prior law, the federal estate tax exemption amount at the first spouse's death was lost if unused or "use it or lose it." Most estate planning focused on the minimization of the estate tax and was accomplished by sheltering the assets at the first spouse's death in what is commonly referred to as a credit shelter trust. At the first spouse's death, assets up to the amount of the federal estate tax exemption of the deceased spouse would pass to the credit shelter trust, rather than outright to the spouse. The assets would be held in trust for the benefit of the surviving spouse and then pass to the children at the surviving spouse's death.

With a significantly larger federal estate tax exemption and the portability of the exemption, most estate plans will no longer be impacted by federal estate tax. Because of portability, married couples will want to consider either leaving the assets outright to their spouse or in a marital trust. The use of a marital trust for a surviving spouse may be preferred in order to protect assets from creditors, to protect the assets from a new spouse in a remarriage and ultimately ensuring the assets pass to the heirs of the first spouse to die, and to protect the assets from mismanagement.

Because of portability, the dilemma ultimately will become whether to hold the assets in a marital trust or hold them in the credit shelter trust. One key factor to consider given the larger federal estate tax exemption is the step up in basis offered to assets at death. IRS rules provide that any appreciated asset receives a new basis equal to the fair market value of the asset at the date

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PORTABLE EXEMPTION VERSUS CREDIT SHELTER TRUST

PORTABLE EXEMPTION	CREDIT SHELTER TRUST
Spouse has access to all assets	Spouse has access to all assets
No inflation protection	Inflationary growth in trust assets avoids future estate taxation
Basis step up at surviving spouse's death	No basis step up at surviving spouse's death
Estate planning is easily understood, meets most couple's expectations, but will require estate tax filings by non-taxable estates and potential document redrafts	Estate planning is somewhat more complicated, harder to understand, but existing estate plans do not require redrafting
No asset protection upon remarriage & divorce unless a marital trust is used	Asset protection provided upon remarriage & divorce
No preservation of inheritance for children unless a marital trust is used	Preservation of inheritance for children
Illinois estate tax exemption is lost	Illinois estate tax exemption utilized
Generation-skipping transfer tax exemption is lost	Generation-skipping transfer tax exemption can be preserved

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of death. If assets have appreciated significantly, the tax on the appreciation will no longer be due after receiving the date of death step up in basis. Likewise, if the stock declines in value, the asset's basis will be set at the lower value. The tax on capital gains is much more favorable than the tax on ordinary income or estate tax and therefore careful consideration must be made to the allocation of assets at the death of the first spouse.

The problem with the traditional approach of transferring the assets to the credit shelter trust at the death of the first spouse, found in many married couples' estate plans, is they do not receive the step up in basis on assets at the second spouse's death. There is a "step up in basis" at the first spouse's death, but none at the second spouse's death. This is because the credit shelter trust is designed to keep the assets out of the estate of the second spouse in an effort to keep the growth in value free from federal estate tax. Married couples now need to consider whether their total estate value will exceed the combined federal estate exemption amount of currently $10.9 million. If their current and projected combined estate value will be less than the inflation adjusted federal estate tax exemption amount, the assets of the first spouse can be left to the surviving spouse either outright or in a marital trust. This will allow the assets to be included in both spouses estates at death, affording them the opportunity to "step up the basis" in the assets at both spouses deaths.

It will be critical that married couples review their estate planning documents with their attorney's to ensure there is sufficient flexibility within their documents to allow for the appropriate choice concerning the family's needs and assets, as well as tax laws, at the death of the first spouse. How assets will be distributed between the marital and credit shelter trust can be determined at the death of the first spouse through various methods not found in many trusts drafted under the traditional approach. To incorporate these methods and take advantage of the "double step up in basis," most married couples will need to revisit their estate plans and documents.

There are many factors to consider when planning for your assets at death. The table on page 2 illustrates some of the key differences to consider between the portable exemption and the credit shelter trust.

2016 DVI HIKE FOR HUNGER

The 10th annual DVI Hike for Hunger will be held on Saturday, August 20th. Every year, DVI teams up with the South Side Mission to raise money to feed the less fortunate in the community. The hike takes place on the grounds of DVI and the Forest Park Nature Center.

*For more information please visit the In the Community page at **www.dviinc.com** or **www.southsidemission.org**.*

DVI ADDS NEW DIRECTOR TO GOVERNING BOARD

We are extremely pleased that Michael L. Dewalt joined the DVI Board of Directors as of March 30, 2016. Mike currently serves as a vice president of Caterpillar, Inc. with responsibility for the Finance Services Division. Functional areas under his leadership include: Corporate Accounting, Treasury, Strategic Planning and Investors Relations. Mike's experience and understanding of the financial services industry will serve as a tremendous resource to both the DVI leadership team and to its independent Board of Directors.

THE PSYCHOLOGY OF RETIREMENT

Over the past several months I've met with a number of clients that are either planning to retire soon or have recently retired. In all cases they are ending long, successful careers and are now faced with the challenge of how to fill their days. The media seems to focus almost exclusively on the financial aspects of retirement with little discussion about building emotional reserves to manage the psychological challenges of retirement. Each of us is probably guilty of becoming overly focused on wealth accumulation as the best retirement planning tool, yet we can all point to friends or colleagues who "failed" at retirement because they were not psychologically prepared.

Too few people consider the psychological adjustments that accompany this life stage. Losing your career identity, replacing support networks you had through work, spending more time than ever before with your spouse, and finding new and engaging ways to stay active all can be problematic. Robert Delamontagne, PhD and author of the book "The Retiring Mind: How to Make the Psychological Transition to Retirement", says some retirees ease smoothly into retirement, spending more time with hobbies or family and friends. But others, research finds, experience anxiety, depression and debilitating feelings of loss. A February 2015 survey of retired baby boomers (ages 63-73) found that 69% had challenges adapting to the emotional changes in their lives. According to the survey, the toughest parts of retiring were missing the day-to-day social connections with colleagues, getting accustomed to a new and different routine, and finding ways to give meaning and purpose to their daily activities.

Research consistently indicates that a sense of fulfillment and meaning throughout retirement helps maintain cognitive, mental and physical health. This is gained through having an engaged and active life. How prepared are you for a post-work mentally stimulating life? An article posted on the Brain and Mind Psychology website dated September 3, 2014 offered the following checklist for consideration:

1. What options for productive activities do you have? (semi-retirement, part-time work, casual work, volunteering, mentoring, being on a board, community service)
2. What are your life style expectations for post-work, and those of your partner?
3. What interests, study, hobbies, or activities have you established already outside of work that you want to continue?
4. What new activities or opportunities have you created to develop a new social network?
5. How do you imagine spending your typical day?
6. What will give you meaning and purpose in retirement?

Author Ernie Zelinski, in his book "How to Retire Happy, Wild and Free" calls retirement life a game. Happy people are the players. Unhappy people are the spectators. Who do you want to be?

CONNIE CASALI RETIRES

The Associates of David Vaughan Investments, Inc. said a bittersweet farewell to a colleague and friend this March. After 14 years of service, Connie Casali has retired from her position as Client Services Associate here at DVI. Connie began her career as an educator for fourteen years before becoming a counselor and program director at various social service agencies. Lastly, she was a corporate trainer for a local business before beginning her tenure at DVI in 2002.

Now in retirement, Connie, her husband, Jim, and their dog, Gracie, have settled in a community on the sunny Florida shoreline, where Connie plans to volunteer at the local forest preserve, become a regular at their local "dog beach," and send daily weather updates to her friends in Peoria. Though she will be greatly missed, we are happy to see Connie off on this grand new adventure, and extend our deepest appreciation for her years of hard work and dedication to the firm, our Associates, and especially our Clients.

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