



WINTER 2009



# trust & investment perspectives



## The Winter of Our Discontent by Nils L. Berglund

With the winter solstice having just passed and investment markets mired in one of the worst and broadest declines on record, I am reminded of the opening line from Shakespeare's *Richard the Third* – surely this has been “the winter of our discontent.” And the winter seems to have lasted for an interminably long time. A year ago we identified many of 2008’s risks and suggested it was a time to be “careful out there,” but we, along with most others, did not anticipate how violently those risks would unfold in cascading valuations for virtually every asset class, domestic and international, over the last several months of the year. Indeed, it was not until late in 2008 that the National Bureau of Economic Research made its official call, stating the economy had entered a recession back in December 2007.

Given that the stock market peaked in the fall of 2007 it is not surprising, in hindsight, to suggest that its decline from that peak was the initial sign that a recession was on the way. As 2008 unfolded, however, it was not always evident that the economy was truly in recession. GDP continued to grow, though haltingly, and corporate earnings, aside from those in the financial services sector, continued to expand. The stock market’s retreat, through

mid-September, seemed fairly normal in the context of an economic slowdown or a modest recession. But then the economy and the investment markets began to unravel. The markets went into a liquidity-driven meltdown that saw the S&P 500, on an intraday basis, lose nearly 28% of its already depressed value during the first eight trading days of October, with not one positive day in that string. Eventually a second wave of forced selling drove the S&P to a late-November low, some 36% below the September 30 close.

At the same time, a new bubble was brewing. Yields on U.S. Treasury obligations plummeted (and prices rose) to unprecedented levels in the fourth quarter as the Federal Reserve undertook

a massive program to inject money into the economy in an effort to stave off a deeper recession. At the same time, the Treasury Department took dramatic action to restructure Freddie Mac and Fannie Mae, allowed Lehman Brothers to slip into bankruptcy, and forced any number of other large financial institutions to partner-up or face the same consequences as Lehman. Then they were handed nearly carte blanche authority by Congress to develop a bailout plan for the financial services sector, in particular, commercial banks. Domestically, the turmoil and uncertainty created by these actions drove money out of stocks and municipal and corporate debt and into Treasury obligations. In late **continued on page 4**



### 2008 Investor Seminar

In October, over 250 clients and guests of Pennsylvania Trust attended our fifth annual Investor Seminar which featured a presentation by David Gergen, editor-at-large at *U.S. News & World Report* and television commentator.

His illuminating presentation, entitled *Beyond the Election: What’s in Store for the Next U.S. President*, provided important insights on the issues confronting the next administration, both domestically and internationally.



## President's Message

Many of my colleagues and friends will tell you that I could constitute my own clippings service. On any given day, I forward, through email, numerous articles culled from my daily reading regimen. It is my hope, of course, to provide insight into a subject of interest to the recipient.

Technology has made the ability to share information infinitely easier and faster. I do suppose the term "clippings service" is dated, as one only needs to google a topic to summon a myriad of references and information. No longer does the mail deliver envelopes stuffed with articles painstakingly hand-cut and pasted to paper, referencing a designated topic or company. We live in a 24/7 news cycle and the quantity of information available can be overwhelming. I will stop short of any editorial comments on quality, however.

But largely I find information empowering. For example, on my desk this winter morning I find daily, monthly, and yearly economic forecasts, performance studies, annual reports, a news release from the Department of the Treasury, and a *New York Times* op-ed piece calling for regulatory reform. On a lighter note, although no less insightful, is investment strategist Byron Wein's annual list of Ten Surprises for 2009. Wein has been putting this list together since 1986, predicting economic, financial management, and political surprises for the year ahead. In previous years, more than half of the elements on the list have proven correct.

So I make notes. Perhaps I forward an article on a company of interest to our Chief Investment Officer, Bill Woolbert. There is a possible sales lead for Bill Haines who heads our marketing efforts. As you will read in this issue, Nils

Berglund's reading list extends beyond financial data to Shakespeare and I know you will find Nils's assessment of the past and present economy honest and illuminating. Trust Administration's Larry Lehrfeld provides information on a change in IRA regulations.

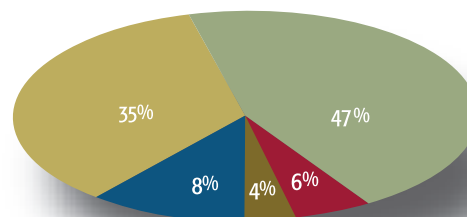
I like to believe that my information gathering benefits those who are the recipients of my forwarded emails but I also hope that you, our clients, are served as well. As your trust company, it is important that all of us at Pennsylvania Trust are knowledgeable and up-to-date on subjects ranging from the state of the local and global economy to government rulings and laws.

There is much reading to be done. Happy New Year!

**Richardson T. Merriman**  
President and Chief Executive Officer

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## Balanced Asset Allocation



- Large Cap
- International
- Mid Cap
- Fixed Income
- Small Cap

# Temporary Waiver of Required Minimum Distribution (RMD) Rules

by Larry H. Lehrfeld



**O**n December 23, 2008, President Bush signed into law H.R. 7327, waiving the 2009 requirement that individuals, who are 70.5 or older, take withdrawals from their Individual Retirement Account (IRA). This is also true for anyone who is the beneficiary of an inherited IRA as well as certain other retirement accounts. Taxpayers are therefore afforded a tax savings opportunity as a result of this temporary waiver of withdrawals.

If you rely on the funds that you traditionally withdraw from your IRA, you may want to consider taking the funds instead from non-tax sheltered accounts. Removing principal funds from non-tax sheltered accounts will not increase the amount of ordinary income you report on your tax return. Under current law, should you need to sell assets to replace the funds that had been coming from your IRA, the gain will be taxed at the preferential 15% tax rate as long as the asset has been held for more than one year. All withdrawals from traditional IRAs are taxed at ordinary income tax rates.

Another benefit of the moratorium on IRA RMDs is the ability to promote additional compounding in the tax-deferred IRA. The greater the IRA balance at the owner's death, the larger the asset that will be there for future generations. All of the earnings and appreciation on the additional retained assets will be tax-deferred until the time of withdrawal by you or your heirs.

### **Benefits of Gifts to Charities**

The ability to make gifts to charities from IRA accounts continues for 2009. IRA owners age 70.5 or older may contribute directly from their account, up to \$100,000 in aggregate, to one or more recognized charities. However, there is a trade-off. By excluding the withdrawal from income, the IRA owner cannot claim a charitable deduction for the contribution. In most cases this is beneficial as it lowers Adjusted Gross Income, an amount that is used in the calculation of the allowable medical expenses and miscellaneous itemized deductions.

### **Clarification Regarding Wash Sales**

In Revenue Ruling 2008-5, the Internal Revenue Service has determined that an individual who sells stock, or other securities, for a loss in a non-IRA account will not be allowed to report a loss for income tax purposes if he or she buys substantially identical stock, or other securities, in their IRA within 30 days before or after the date of the sale. This officially puts an end to a technique attempted by some taxpayers.

### **Maximize the Advantages of an IRA**

Depending on your age, it is almost always a good idea to contribute as much as the law allows into a traditional or Roth IRA for yourself and your spouse. April 15, 2009 is the deadline to make contributions for tax year 2008. You may be entitled to a tax deduction, but even if not, you will get many years

of tax-deferred growth and earnings. In the case of a Roth IRA, there is no requirement that funds be withdrawn beginning at age 70.5 as there is for a traditional IRA. However, there are income limitations that may impact your ability to make contributions to a Roth IRA. For self-employed individuals there are variations on the traditional IRA, such as a SEP, SIMPLE, or Solo 401(k) plan. These plans have higher contribution limits than a traditional IRA.

One of the most important aspects of having an IRA is the designation of a beneficiary. Failing to have a properly completed beneficiary designation form can have unfortunate tax results. IRA owners need to make certain that the IRA custodian has a current beneficiary form. Coordinating your beneficiary designation with your estate plan can provide opportunities to stretch the payout of the IRA, and the tax deferral, for generations. It is prudent for IRA owners to periodically review their beneficiary designations with their estate or financial planner.

We look forward to working with you to ensure that your IRA is structured to best suit your investment needs. If you have questions or would like to discuss this topic in more detail, please contact your Pennsylvania Trust administrative officer.

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*Mr. Lehrfeld is Senior Vice President, Tax Administration, at Pennsylvania Trust.*

**continued from page 1** December, three-month U.S. Treasury Bills were yielding a paltry .02%, three-year notes 0.99% and the ten-year note 2.09%. It is hard to envision any of these obligations rewarding investors with inflation-adjusted returns over any reasonable time period. It is all about safety and liquidity.

There was little doubt that the economy continued to weaken as 2008 drew to a close. Retail sales at Christmas were dismal, even with prices slashed to entice buyers. Home prices have continued to slide in most regions of the country and foreclosures are rising. The bailout has not yet had its desired impact to reinvigorate lending as banks have tended to hoard their bailout funds. Unemployment continues to expand. Productivity, the backbone of so much of our economic growth in recent years, has lost ground. The domestic auto manufacturing industry is on the verge of bankruptcy. The full

cost of the bailout remains undetermined, but it will be huge. Iraq, Afghanistan, and the entire Middle East remain areas of significant contention and expense. Corporate earnings are dropping and expectations for future earnings are very uncertain.

Sentiment regarding the economy could not be worse today. But, that is when history suggests we should begin to explore the stock market for an eventual recovery. Valuations, based upon long-term records for many companies, are at historically cheap levels. Dividend yields for many of these companies are very attractive and for others with solid records of earnings growth, their prices are similarly appealing. And I am reminded, as I reflect on this potential opportunity, that Richard's opening soliloquy is not a lament of his unpleasant circumstances, but rather he continues that "the winter of our discontent" is: "made glorious sum-

mer by this sun of York; And all the clouds that low'r'd upon our house in the deep bosom of the ocean buried." The opening of the play actually finds Richard proclaiming that the winter has given way to a "glorious summer" and the clouds that hung over his fortunes are now buried in the deep. Hopefully 2009 will find our fortunes turning to the better as the market's decline ebbs and an economic expansion once again seems possible.

Not yet willing to recommit reserves to the market, our long-term asset allocation for stocks remains at 65%, with our stock allocation being 72% in large cap, 10% mid cap, 6% small cap and 12% international. The 35% balance in fixed income and cash equivalents includes 5% reserved for reinvestment in equities.

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*Mr. Berglund is Senior Vice President of Portfolio Management at Pennsylvania Trust and a member of the Investment Committee.*



Bernard Corey, *Red Barn in Snow*, oil on canvas

## Painting Profile

***Pennsylvania Trust is proud to feature the work of artists such as Bernard Corey (1914-2000). Born in Grafton, Massachusetts, Corey is considered one of the very best New England plein air artists of the 20th century. Primarily self-taught, Corey drew his inspiration from nature and felt that it was important to paint directly from the source as opposed to working in the studio or from photographs. He achieved national recognition, winning several gold medals and scores of awards. He was an active member of the American Watercolor Society, Allied Artists of America, Guild of Boston Artists, Salmagundi Club, American Artists Professional League among many other organizations. Corey was a founding member of the Blackstone Valley Art Association.***



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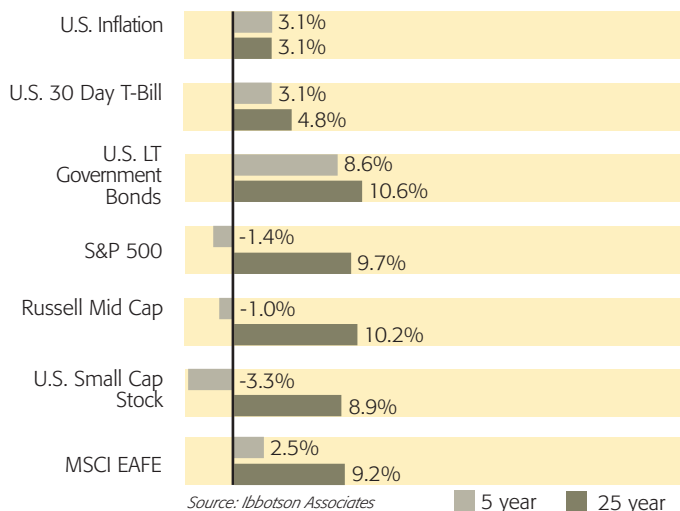
Pennsylvania Trust is committed to conduct all our relationships with integrity and to maintain the highest ethical standards; provide outstanding professional and personalized services; produce superior investment results consistent with client objectives; and retain exceptionally skilled individuals, empowering them with state-of-the-art technology.

# Market Indicators

	Current	Three Months Ago	One Year Ago
<b>Stock Indices</b>	12/31/08	9/30/08	12/31/07
Dow Jones Industrial Average	8,776	10,851	13,265
Standard & Poor's	903	1,166	1,468
<b>U.S. Treasury Yields</b>			
2 Year	0.8%	2.0%	3.0%
5 Year	1.5%	3.0%	3.4%
10 Year	2.2%	3.8%	4.0%
30 Year	2.7%	4.3%	4.5%

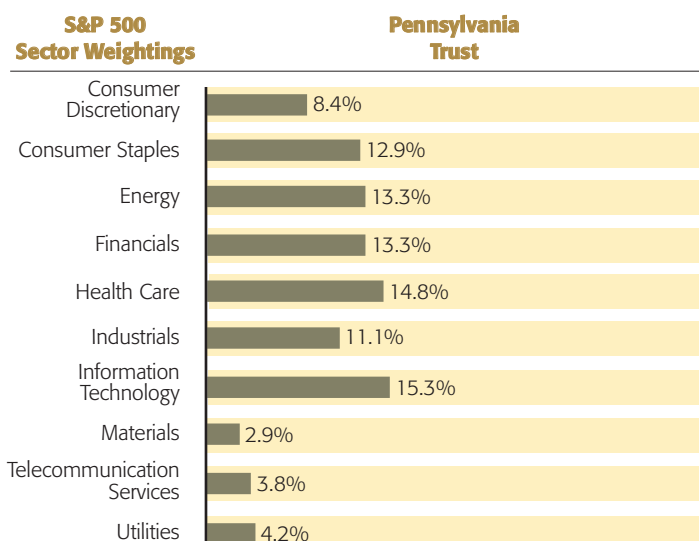
## ANNUALIZED RETURNS OF SELECT ASSET CLASSES

Over the past 25 years, equity returns have outpaced bonds, cash and inflation.



## CORE LARGE CAP DIVERSIFICATION

In order to maintain a well diversified large cap common stock portfolio, we recommend the following relative sector weightings within the Standard & Poor's 500:



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