PENNSYLVANIA TRUST

25 YEARS

SPRING 2011

trust & investment perspectives



Confounding the Bears

by Willard N. Woolbert

Adding to the list of issues confronting the equity markets, last quarter we saw a massive, tragic, and disruptive earthquake and its consequences in Japan, equally historic political changes in North Africa and the Middle East that pushed oil prices to over $100 a barrel and gas prices to $4 per gallon. In Washington, we faced a shutdown of the Federal government over a failure to pass last years' budget let alone confront the issues of deficits in the coming years. Commodity prices and deficits are up and the dollar is down, reminding all of the inflation problems of the 1970s. Europe's finances remain a mess. Ireland needs more money and Portugal has lost a government over required austerity measures. Emerging markets, the real global growth story, face tighter monetary conditions as their central banks raise interest rates to control growth-induced inflation. Yet in February, the S&P 500 reached 1,344, fully 100 percent above its panic low in March 2009 and enjoyed its best first quarter return since 1998. What is driving the market higher given the litany of problems we face? We find three sources of strength that, at least for the moment, have overwhelmed the negatives.

- The Federal Reserve is continuing with its quantitative easing program (QE2). With economic activity still subdued, the money being created by QE2 has found its way into financial assets. The S&P 500 has risen by 30% from the day in August when Chairman Bernanke announced the plan for QE2. Increasing asset values and wealth is more important to the current recovery than in the recent past. There is a close correlation between wealth and savings. During the late 1990s and even during part of the last decade, the savings rate was low, even becoming negative at one point, as both equity and home prices enhanced wealth. With the decline in both factors over the past three years, the savings rate has moved higher, now stable around 6%. It is more critical to this recovery that we, as consumers, do not hoard cash, as this time around we will not benefit from increased borrowing. Post-World War II recoveries, and particularly those since 1980, have featured borrowing to jumpstart the economy. This time, it looks as if the private sector has finally exhausted the credit card and home equity loan.

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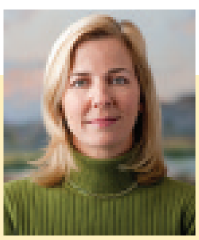


Leslie Gillin Bohner Adds Expertise to Trust Administration

Pennsylvania Trust is pleased to welcome Leslie Gillin Bohner, Esq. as Senior Vice President, Trust and Account Administration. Her responsibilities include trust, estate and account administration, as well as estate planning.

Prior to joining Pennsylvania Trust, Leslie spent 16 years at Drinker Biddle & Reath, LLP where her practice encompassed estate planning and administration, litigation of estate and trust related disputes and counseling of fiduciaries in the areas of trust and estate administration. Most recently, she served as Director of Legacy Planning at SEI Investments Corporation, providing estate planning and philanthropy advice to ultra high net worth clients.

Leslie is a member of the Probate and Trust Law Section of the Philadelphia Bar Association and the Philadelphia Estate Planning Council.

President's Message

"Change is the order of the day." So begins a timely poem composed by an acquaintance of mine. The verse continues with the age-old lament that nothing seems to stay the same despite our oft longing that it might. Even so, the author reminds us that if in fact, "change ceased, we'd lose the play in all of us that makes us aim beyond ourselves."

Great change is afoot at Pennsylvania Trust as we recently completed a significant restructuring that positions us as independent and employee owned. While we have enjoyed many years as a proud partner with The Penn Mutual Life Insurance Company, an enterprise that has supported and shared our philosophy of outstanding client service, we are now moving in a new direction. With this next step, a new ownership group, led by those who have managed Pennsylvania Trust over the last six years, takes us forward toward greater success with confidence and a proven track record of excellence. Change is making us better.

I am proud to continue to lead Pennsylvania Trust as Chairman, President, and Chief Executive Officer, ably supported by our excellent team of four business unit heads as well as Executive Vice President George McFarland. Both George and I will serve on the Board of Directors alongside three outside directors whose successes, as executives in the financial services industry, will lend valuable perspective and insight. Dick Miles, Managing Director of Berkshire Capital Services, served as our first board chair 25 years ago and I am delighted that he rejoins us at this juncture. With him is Gary Schlarbaum, former Managing Director at Morgan Stanley and Jim Wolitarsky, former President and Chief Executive Officer at Janney Montgomery Scott, also a former board member who chairs our Audit Committee.

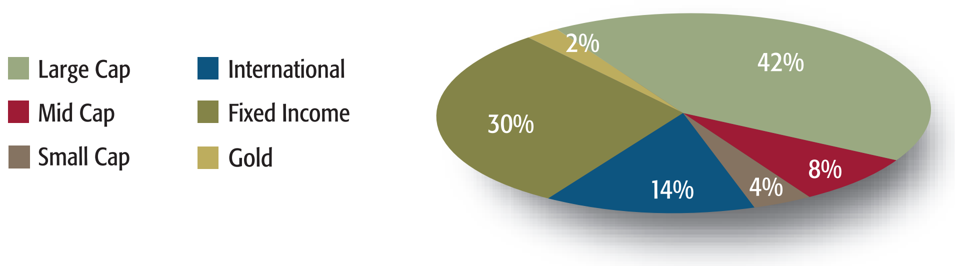
We also welcome new colleagues such as Trust Administration's Leslie Gillin Bohner who writes in this issue on the salient topic of estate planning and how it is affected by change. Also in this issue, Bill Woolbert offers a spot on analysis of the ever-changing financial markets which I know you will find provocative.

New owners, new board, new colleagues, yes, but our vision to provide outstanding wealth management services, tailored to the unique needs of our clients, remains unchanged.

Author Jim Collins, well known for his best selling management studies, *Built to Last* and *Good to Great*, writes about how the most successful companies have long-term sustained performance engineered into their DNA. They are never satisfied with complacency. In this year's annual message, I boast that excellence is a habit at Pennsylvania Trust. As Collins suggests, it is part of our genetic make up. I think the poet I reference at the beginning of this message sums up the relationship between success and change quite well when he writes, "and change, the order of the day, ensures the worth of things that stay."

Richardson T. Merriman
Chairman, President,
and Chief Executive Officer

Balanced Asset Allocation



TRUST TALK

Do I Still Need an Estate Plan?

by Leslie Gillin Bohner, Esq.

Recent tax legislation has many people wondering if they still need an estate plan. The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the "2010 Tax Relief Act") increases the federal estate tax exemption to $5 million and provides for "portability" of the exemption between spouses. Why is everyone talking about portability? Before this year, a deceased spouse's unused exemption could not be used by the surviving spouse. So, if the first spouse left everything outright to the surviving spouse, that spouse's exemption amount would be wasted with the result that more assets would be subject to estate tax in the survivor's estate. Married couples could avoid this result by setting up trusts (often referred to as a bypass trust/marital trust or an A/B trust) as part of their estate plan. Under a bypass trust plan, when the first spouse dies, an amount equal to that spouse's exemption amount is used to fund the bypass trust and the excess passes to the marital trust (or outright). At the surviving spouse's death, the assets remaining in the bypass trust "bypass" the survivor's estate and are thus not subject to estate tax. With portability, the first spouse can now leave everything outright to the survivor, without the need for a bypass trust, and the first spouse's unused exemption amount can be used by the survivor. But don't be deceived by portability's apparent simplicity. You absolutely still need an estate plan.

At a minimum, everyone should have the following basic estate planning documents: a will; a durable power of attorney; a health care power of attorney; and a living will. In your will, you can direct the transfer of your property at your death, appoint your executor, appoint a guardian for minor children, and create trusts. If you die without a will (intestate), state law controls the disposition of your property and can make the settlement of your estate more difficult. By executing a financial power of attorney and designating an agent to handle your property, you can avoid the costly process of obtaining a court-appointed guardian. A health care power of attorney enables your designated agent to make medical decisions for you. A living will permits you to state your intentions concerning end-of-life care. Beneficiary designation forms for retirement plans and life insurance are also part of your estate plan.

And, if you are married, you may still need a bypass trust. First, there are risks associated with relying on portability. The portability provision in the 2010 Tax Relief Act is currently set to expire on December 31, 2012. This means that there is no certainty that a deceased spouse's exemption amount will be available if the surviving spouse dies after 2012. Additionally, in order to take advantage of portability, the executor of the first spouse's estate must make an election on a timely filed federal estate tax return, even though no tax may be due. No election, no portability. Finally, bypass trusts will remain an important part of many estate plans for the following reasons:

- Leaving assets to a bypass trust, instead of outright, can ensure professional asset management by a trustee.
- Leaving assets to a bypass trust, instead of outright, can shelter family assets from creditors, such as plaintiffs and ex-spouses of children.
- Leaving assets to a bypass trust can ensure that the assets are used as the first spouse intended, e.g., not for the benefit of a new spouse.
- Leaving assets to a bypass trust removes from the survivor's estate both the assets and any appreciation on those assets between the first and second deaths.
- Portability does not apply to the $5 million generation skipping transfer tax (GST) exemption. A bypass trust can be used to accomplish GST planning.
- Portability does not apply to state estate tax exemption amounts. A bypass trust can be used to preserve the first spouse's state estate tax exemption.

In light of this significant new estate tax legislation, it is prudent to review your estate plan. Pennsylvania Trust's experienced staff of professionals stands ready to work with you to ensure that your estate plan is aligned with your wealth transfer goals.

Ms. Bohner is Senior Vice President, Trust and Account Administration, at Pennsylvania Trust.

continued from page 1 Consumer spending will have to come from income and a much higher savings rate would quickly curtail the recovery. Creating wealth through increased liquidity is the real goal of QE2. Unfortunately QE2 will end in June. This is clearly a risk for the markets, but for the time being it is the principal engine of the advance.

- Short-term interest rates remain near 0%. This is the older sibling of QE2. The Fed's first, and traditionally primary lever to stimulate the economy, is to reduce short-term interest rates. In 2009 it was a way to force investors, particularly yield-oriented investors, to take some risk. They did so by crowding into bonds and bond funds. Longer-term yields fell and some handsome returns were achieved as bond prices recovered from the desperate levels of late 2008 and early 2009. With all yields now reduced and concern about inflation increasing, investors are beginning to return money to equities as indicated by recent mutual fund flows. While not related to yield, traditional buyers of stocks such as pension funds are grossly under-weight equities in their asset allocations. All of this suggests that there is an underlying demand for equities. We think that short-term rates will remain low well beyond the end of QE2, providing a continuing lift to the market.

- Equity prices follow earnings, and profit growth has been remarkably good given the muted economic recovery. Using national income account figures, corporate profits have already surpassed their 2007 level. Unfortunately, a good part of the improvement has come from reduced employment rather than revenue growth, but profits and importantly, cash at the company level, are trending up. Dividend increases are accelerating, stock buy-backs by companies are up and merger activity is increasing. This is all supportive of stock prices and is the aspect of this recent advance that will need to buoy the market beyond the end of QE2.

We began with a list of problems that the market has managed to overcome over the recent six months with an expansive Fed and improving earnings. While the impact of QE2 will be lost in the second quarter, low rates and better profits can support the market for a while longer. However, unaddressed structural deficit and debt problems of Europe, Japan, and the U.S. must eventually overwhelm the cyclical benefits of recovery. But for now, investors are supporting equities as the primary beneficiary of the Fed's largesse.

Mr. Woolbert is Senior Vice President and Chief Investment Officer at Pennsylvania Trust.

Community Day – Sunday, April 3, 2011 Lunch Served at Our Brothers' Place

One thousand meatballs, 50 pounds of pasta, plus bread, salad, and dessert for 200 topped the menu when Pennsylvania Trust staff volunteers prepared and served lunch at Our Brothers' Place, a Center City men's shelter. Our Brothers' Place is part of The Bethesda Project, a social services organization whose mission is to provide a caring family atmosphere for Philadelphia's homeless population.

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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
Stock Indices	3/31/11	12/31/10	3/31/10
Dow Jones Industrial Average	12,320	11,578	10,857
Standard & Poor's	1,326	1,258	1,169
U.S. Treasury Yields			
2 Year	0.8%	0.6%	1.0%
5 Year	2.3%	2.0%	2.5%
10 Year	3.5%	3.3%	3.8%
30 Year	4.5%	4.3%	4.7%

ANNUALIZED RETURNS OF SELECT ASSET CLASSES

	5 year	25 year
U.S. Inflation	2.2%	2.9%
U.S. 30 Day T-Bill	2.0%	4.1%
U.S. LT Government Bonds	6.3%	8.1%
S&P 500	2.6%	9.6%
Russell Mid Cap	4.7%	11.4%
U.S. Small Cap Stock	2.3%	10.5%
MSCI EAFE	1.8%	7.6%

Source: Ibbotson Associates

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:

S&P 500 Sector Weightings		Pennsylvania Trust
Consumer Discretionary	10.5%	=
Consumer Staples	11.2%	–
Energy	12.7%	+
Financials	15.0%	–
Health Care	11.0%	–
Industrials	11.2%	+
Information Technology	18.7%	+
Materials	3.6%	–
Telecommunication Services	3.0%	=
Utilities	3.1%	–

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