Investor Insights and Outlook

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Custodial Accounts: A Way to Transfer Wealth

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Setting up a custodial account can be a savvy move for adults who want to gift their assets and help their children become financially independent. They are simpler to set up than trusts. But there are many considerations -- and consequences -- to weigh before opening an account. Here are some key points to keep in mind.

UGMA and UTMA

The two types of custodial accounts you can use to gift assets to your youngster are called a Uniform Gift to Minors Act (UGMA) or Uniform Transfers to Minors Act (UTMA). Which one you use will depend on your state of residence. Most states -- with the exception of Vermont and South Carolina -- have phased out UGMA accounts and now only offer UTMA accounts. UTMA accounts allow the donor to gift most security types, including bank deposits, individual securities, and real estate. UGMA accounts limit gifts to bank deposits, individual securities, and insurance policies.

There are no contribution limits. Parents, grandparents, other relatives, and even non-related adults can contribute any amount to an UGMA/UTMA at any time. Note that the annual federal gift tax exclusion is currently $14,000 per year ($28,000 for married couples). Gifts up to this limit do not reduce the $1 million federal gift tax exemption.

The assets gifted are irrevocable. Once you establish an UGMA or UTMA, the assets you gift cannot be retrieved. Parents can set themselves up as the account's custodian(s), but any money they take from the account can only be used for the benefit of the custodial child. Note that basic "parental obligations," such as food, clothing, shelter, and medical care cannot be considered as viable expenses to be deducted from the account.

Taxes are due -- potentially for both you and your child. Some parents may initially find custodial accounts appealing to help them reduce their tax burden. But it's not that simple. The first $1,000 of unearned income is tax exempt from the minor child. The second $1,000 of unearned income is taxable at the

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Advisor Corner

Thank you for the opportunity to serve as your advisor.

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Custodial Accounts, continued

child's tax rate, which could trigger the need for you to file a separate tax return for your child. Any amounts over $2,000 are taxable at either the child's or the adult's tax rate, whichever is higher. Note that state income taxes are also due, where applicable.

Your child will eventually gain complete control. Once your child reaches the age of trust termination recognized by your state of residence (usually 18 or 21), he or she will have full access to the funds in the account. Be warned that your child could have different priorities for the assets in the account than you do. Money that parents had earmarked as paying for college tuition could instead be used to purchase a sports car or fund a suspect business venture.

Financial Aid Considerations

For financial aid purposes, custodial assets are considered the assets of the student. If the assets in the account could jeopardize your child's chances of receiving financial aid, speak to your tax and/or financial professional. One of your options could involve liquidating the UGMA/UTMA and establishing a 529 account.

Before making any decisions about establishing a custodial account, be sure to talk to your tax and financial professionals.

This communication is not intended to be tax advice and should not be treated as such. Each individual's tax situation is different. You should contact your tax professional to discuss your personal situation. Because of the possibility of human or mechanical error by S&P Capital IQ Financial Communications or its sources, neither S&P Capital IQ Financial Communications nor its sources guarantees the accuracy, adequacy, completeness or availability of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information. In no event shall S&P Capital IQ Financial Communications be liable for any indirect, special or consequential damages in connection with subscriber's or others' use of the content.

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Talk with Jim to find out how a custodial account could fit your goals and your financial plan.

Know Your Risks

Risk is the chance that you won't be able to meet your financial goals or that you'll have to recalibrate your goals because your investment comes up short. Investors face many forms of risk depending on the kinds of investments they choose.

Market, industry, and company risk: General market fluctuations can affect securities trading in that market. Stocks tend to fluctuate more than other asset classes, and may pose more risk over short periods of time. Investors looking to time the market run the risk of jumping into the market during the worst times, and out of the market during the best times. Security values can also decline from negative developments within an industry or company.

Credit and interest-rate risk: Credit risk is the possibility of a bond issuer not being able to make timely payments of principal and interest. The value of a bond may also decrease due to financial difficulties or the declining creditworthiness of the issuer. Interest -rate risk relates to how bonds tend to rise in value when interest rates fall, and to fall in value when interest rates rise. Typically, bonds with longer maturity exhibit greater price volatility.

Inflation risk: Inflation is a rise in the general level of prices for goods and services. If investments do not keep up with inflation, an investor's money will purchase less in the future than it did in the past. Liquidity risk: Some investments may not be widely held by the public and may be difficult to sell if prices drop dramatically.

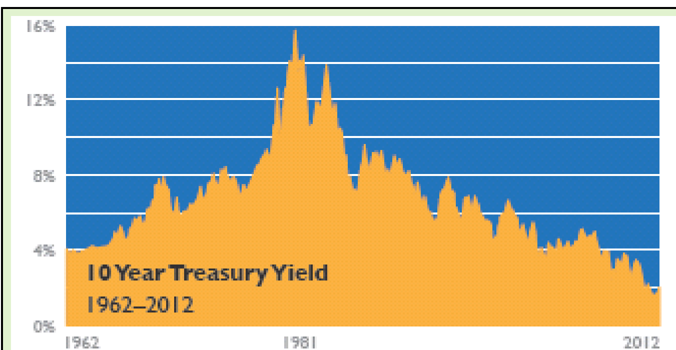
Currency risk: Returns achieved by local investors are often different from returns achieved by U.S. investors because of foreign exchange rates, even though both are investing in the same security.

Hidden Risks in Bonds

by **Matthew Carvalho, CFA, CFP Director of Investment Research,** Loring Ward

We've all been taught that stocks are more risky than bonds. And for much of the last eight decades that as been true. But also true over the last 30 years is that interest rates have been falling. - Is has created a tailwind for bonds.

Why are falling rates good for bond prices? Imagine you buy a bond today for $1,000 that will pay you a coupon of 5% for the next 10 years. If the next day interest rates fall to 4%, would you rather have the bond from yesterday paying you 5% a year or the bond from today paying you 4%? Obviously the bond paying you 5% is going to be more attractive, and therefore its price — and your total return — will go up.



Source: 10 Year Treasury Yield from Yahoo! Finance, March 2013. Bonds represented by Long Term Government Bond Index Total Return, Stocks represented by S&P 500 Total Return from DFA Returns 2.2, March 2013. Indexes are unmanaged baskets of securities that are not available for direct investment by investors. Index performance does not reflect the expenses associated with the management of an actual portfolio. Past performance is not a guarantee of future results. All investments involve risk, including loss of principal.

Interest rates and bond prices move inversely — when one goes up, the other goes down. As you can see from the chart , over the last 31 years interest rates have been falling, from a peak in late 1981. When that happens, it has a positive effect on the price of those bonds already trading in the market. As you can see from the following table, during those 31 years, a Long-Term Government Bond Index had an average return of 10.81%. However, from 1962-1981, the return averaged just 2.64%. During that time frame, that index had a negative annual return on eight occasions, more often than the S&P 500.

	Rising Rates	**Falling Rates**
Timeframe	1962-1981	1982-2012
Bonds	2.64%	10.81%
Stocks	6.77%	11.14%

The amount of interest rate risk inherent in any given bond can be quantified by a measure called Duration, a calculation of the average time it takes you to receive your investment back. For example if you bought a 1-year bond with no coupon, your duration would be 1; a 10-year bond with no coupon would have a duration of 10. Most bonds do pay a coupon, which means you get the sum of your original investment back a little earlier than the maturity date.

Duration can serve as a good estimate of what just might happen to the price of your bond when interest rates change. - e calculation is simple, take the negative of the change in interest rates multiplied by the duration of your bonds. For example, if rates rise by 1%, and your bonds have a duration of 10, you can expect the price of your bonds to decline by about 10%, for just that 1% change in interest rates. A bond with a duration of 10 should see price movements about three times as large as a bond with a duration of 3. - Therefore shorter-term bonds have less reaction to interest rate movements than longer term bonds.

Remember, as an investor your goal should be related to the total return on your portfolio, not just the income or capital gains of any one piece. Bond investors can normally expect some amount of income or yield from their bond investments, but the principal gains or losses caused by interest rate changes can potentially be much larger than those coupons, especially when rates are as low as they are now.

With current short-term rates near zero, we'd all like to be able to squeeze an extra 1-2% of yield from our investments. But when it comes to the current bond yield environment, we must ask ourselves, is it worth it to take on a large amount of additional risk in order to try and pick up that tiny bit of yield? Will it make a real difference to our long term financial goals? We don't know when or which way interest rates will move. But we do know that rates have come down significantly over the last three decades. Whether rates move tomorrow or three years from now, it's never a bad time to take a look at your bond exposure with your financial advisor and make sure you understand.

10 Questions to Ask When Selecting and Titling an Annuity

While by no means a comprehensive list, these questions help cover the basics of selecting and titling an annuity.

1) Who gets the payout when different parties on the contract die? **2)** Whose death triggers the enhanced death benefit to pay out? On a contract with spouses, not all contracts pay out the enhanced death benefit when either spouse dies. **3)** If spousal continuation occurs, is the contract continued at the enhanced death benefit value or just the current account value? And, if continued, are the surrender charges waived? Death benefit values in excess of the account value may be available. **4)** If spousal continuation occurs, what happens to the various benefits on the contract? Do they terminate, reset, or continue uninterrupted? **5)** How do withdrawals impact the different living and death benefits on the contract? **6)** For qualified money, how do Required Minimum Distribution (RMD) withdrawals impact the different guarantees? RMD withdrawals can erode a benefit. **7)** Do guarantees on the contract stop or simply level off when clients reach older ages? **8)** Is annuitization forced at a particular age? **9)** If a trust is the owner of the annuity, whose death will cause the contract to pay out? **10)** If a trust is the recipient of the annuity assets, and the surviving spouse is the sole beneficiary of the trust, is spousal continuation allowed? Pay special attention when working with trust ownership or trust beneficiaries.

Annuities are suitable for long-term investing, particularly retirement savings. Annuity risks include market risk, liquidity risk, annuitization risk, tax risk, estate risk, interest-rate risk, inflation risk, death and survivorship risk, and company failure risk. Consult your financial advisor, estate lawyer, or tax professional to determine which annuity product best caters to your individual needs.

How to Save Money on Schwab Equity Trades

Electronic delivery of your account documents, such as statements and trade confirmations is available via SchwabAlliance.com, the Schwab Advisor Services website designed exclusively for clients of independent investment advisors that custody at Schwab.

Go paperless and you'll benefit from:

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If you are interested in signing up you have three options:

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- Call Schwab Alliance at 800-515-2157
- Contact us for more information or to initiate the registration on your behalf.

Schwab is committed to protecting your privacy. Electronic delivery of your account documents on their secure website is safer and faster than traditional mail delivery. Schwab uses Secure Sockets Layer (SSL) encryption technology, a secure communication protocol designed to reduce the chance of anyone intercepting or viewing your personal information.

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