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ViewPoint

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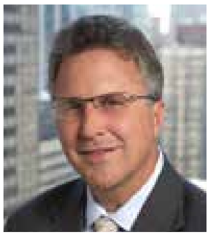
Global economic growth continues despite headwinds



Benjamin A. Pace III,
Chief Investment Officer–Americas

Ben Pace met with ViewPoint to update his recent outlook on global economies and markets in 2013

ViewPoint: Between sequestration and the continuing fiscal crisis in Europe, it seems as if there are forces in place that could affect the U.S. economy adversely. How vulnerable are we?

Mr. Pace: Let me address Europe first. I maintain that it is the rest of the world that is vulnerable to U.S. economic conditions—and not the other way around. Five years ago, we were talking about decoupling—the possibility that what happens in the U.S. would not matter as much to the rest of the world, given the explosive growth of emerging economies. In 2008, however, the U.S. economy was down 4%, and the rest of the world suffered. Now that the U.S. is firmly in recovery mode, the rest of the world should benefit. The U.S. is still the most important determinant of the direction of world economic growth, but the magnitude of that growth will be determined by the growth rate of emerging economies.

ViewPoint: But what about Cyprus, where the government had to close banks for fear of a run by depositors? Isn't there a chance that panic could spread to other vulnerable countries like Spain, Italy and Portugal? And if it did, wouldn't the U.S. be affected?

Mr. Pace: That is a worst case scenario in which the European debt situation infects the world economy and produces a credit freeze similar to the one the U.S. suffered five years ago. The fact that European debt is largely held in European banks is a mitigating factor. If a number of European banks failed, would American banks stop lending? Perhaps, but I doubt that it would freeze credit extension in the same way that the Lehman bankruptcy did in 2008.

It is important to point out that during the recent events in Cyprus, there were no similar problems in other European countries. Furthermore, European stocks are up 20% since last fall, even though Eurozone growth was down 1.2% as of the end of last year. I do not want to minimize the situation, but remember that before it embarked on two decades of stagnant growth, Japan was the second largest economy in the world. But remember too that the rest of the world was not greatly affected. Today, Europe is the second largest economy in the world and it could very well be stagnant for the next few years. As long as the U.S. economy is growing, however, and Emerging Markets continue to thrive, world economies and markets should also prosper.

ViewPoint: What about sequestration?

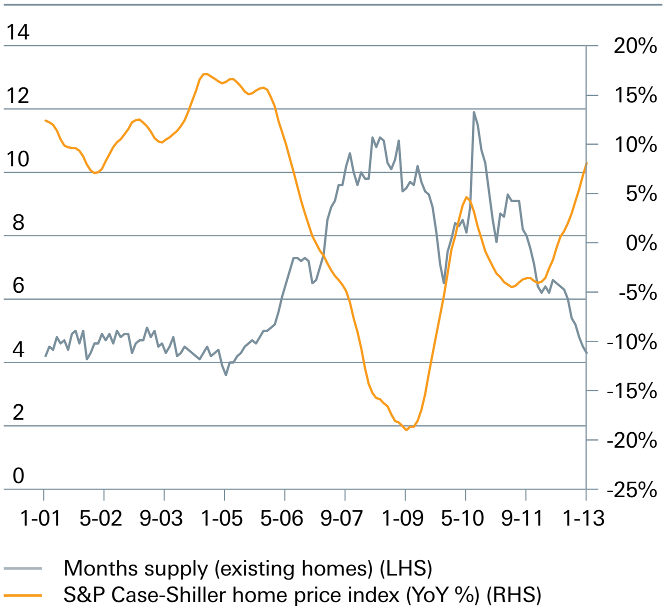
Mr. Pace: It will not be as painful as it could have been if Congress had not reached agreement on the fiscal cliff tax issues at the end of last year. It will also not be as painful as government austerity programs in Europe. Like a number of European governments, the U.S. government is overleveraged, but it is better to implement austerity programs when your economy is growing 2.0%–2.5% than when it is in recession. To add a little perspective, remember that sequestration forces spending cuts that amount to $89 billion a year. Currently, the Fed is purchasing $85 billion in Treasury securities every month. In addition, these cuts may be modified after further Congressional negotiation. Overall, we expect sequestration to reduce GDP by approximately 50 basis points, which is a lot better than the 3%–4% reduction that would have taken place if Congress had let us plunge over the fiscal cliff. Moreover, there are a number of positives in place that may enable our economy to withstand the impact.

ViewPoint: You mentioned in our last discussion that the housing market is picking up. Is that one of the positives?

Mr. Pace: Yes. Prices, for the most part, have stopped declining and excess inventory has been largely worked off (see Exhibit A). For the first time in five years, housing should contribute to U.S. GDP. But that is not the only positive we see.

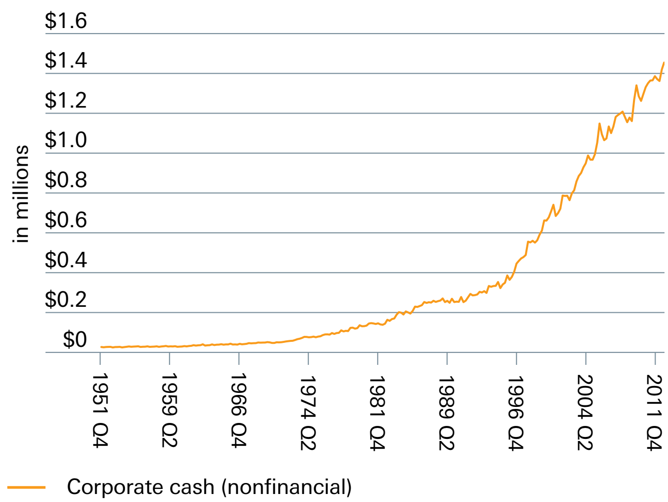
Consider the basic GDP calculation: Consumption plus Investment Spending plus Government Spending. Government spending will probably be declining over the next decade because of sequestration and an overall sense that we are overleveraged and must take measures to reduce our deficit. Investment spending, however, is key. Companies, for the most part, have already deleveraged, and many have huge sums of cash on their balance sheets (see Exhibit B). Some have been spending cash to a degree on mergers and acquisitions, share buybacks and dividend increases. Now we are getting a sense that they are beginning to spend on capital equipment. If reduced government spending could be replaced by more efficient private sector spending, that could be a major plus for long-term economic growth.

Exhibit A
Home prices are rising while inventories fall



Source: Bloomberg Finance LP

Exhibit B
Corporate cash is growing



Source: Federal Reserve Bank

ViewPoint: What about Consumption?

Mr. Pace: Six years ago, we had a negative savings rate. Today, consumers are saving at a rate of about 4%. In addition, the job market is improving and consumers with jobs are generally seeing an increase in wages. So while we still have a way to go, we seem to be making progress. The linchpin is capital spending—will businesses begin to spend the huge sums of cash on their balance sheets? We see some evidence that they have already begun to do so.

ViewPoint: Let's shift gears and look beyond the U.S. What do you see for Europe and the Emerging Markets?

Mr. Pace: Despite the recent run-up in European stocks, the Eurozone economies continue to struggle. While it is popular to divide Europe into strong Northern Tier countries like Germany and weak Southern Tier countries like Greece and Italy, it is just not that simple. The Benelux countries—Belgium, The Netherlands and Luxembourg—are all running large deficits. France is taxing people at rates as high as 75%, not exactly an environment conducive to wealth creation and entrepreneurism. Germany has obviously been the star performer, but I would maintain that one of the reasons for its success is the fact that its people have already lived through austerity with the incorporation of East Germany in the 1990s. This experience led to a new generation of less government-dependent, entrepreneurial citizens. Even with this advantage, however, Germany has a negative birth-to-death ratio, tight immigration policies and an overreliance on exports.

ViewPoint: Let's talk about Emerging Markets. After a period of exponential growth several years ago, they seem to have had their problems lately. What happened and what do you foresee for them over the next few years?

Mr. Pace: After 2008, growth in the Emerging Markets was explosive. In fact, growth was so pronounced in 2009 and 2010 that the central banks of many Emerging Market countries began to tighten monetary policy in an effort to curb potential inflation. They achieved their goal but slowed down the economies of such countries as China, India, Brazil and Mexico to such a degree that many economists wondered if they had overdone it. Going into last year, there were concerns that China would experience a hard landing. As it turned out, these fears were unfounded. Since the beginning of this year, U.S. stocks are up 9%, European stocks are up 5%, but Emerging Market stocks are flat. At the same time, earnings have been growing in double-digits. As a consequence, we like Emerging Market stocks and look at them as a buying opportunity.

ViewPoint: Are you as optimistic about U.S. stocks?

Mr. Pace: We have been underweight U.S. large cap stocks, but that could change shortly. The U.S. economy is stronger than the economies of other developed markets, so stocks should benefit.

As you might expect, we are underweight European stocks. And even though Japanese stocks have performed well recently, primarily due to the weakening yen, we are underweight.

ViewPoint: Do you have any advice for fixed-income investors in today's low-yield environment?

Mr. Pace: We like Emerging Market debt. Short-term interest rates in these countries are well above zero and monetary authorities have sufficient room to decrease them, if necessary.

We also continue to favor high-yield bonds, even though we realize that price appreciation is largely behind us. Last year, high yield performed as well as equities. We do not see that continuing, but default rates are very low and high yield could still be an option for both yield-conscious and total return-oriented investors.

ViewPoint: What is your outlook for commodities?

Mr. Pace: I am not sure we have come to the end of the supercycle that began in 2002, but it is interesting to look back at this asset class over the past 20–30 years. In the 1990s, gold was stuck in the $300 range. In the 1990s, oil was in the low 20s. Many investors had given up on commodities as an asset class and low prices forced producers to consolidate and eliminate capacity. In the first decade of this century, prices began to be bid up by the fast-growing Emerging Market economies. After the recession of 2007–2008, as super easy monetary policy was implemented by the Central Banks, this trend accelerated. Furthermore, demand for commodities increased as a result of Emerging Market growth, but capacity or supply had been reduced greatly. The result was spiraling prices. The spiral may have run out of fuel, however. Capacity has been built up over the years, so the disparity between supply and demand has shrunk. As a result, we see flat, trendless markets for the next year or so.

An alternative store of value to investigate, however, is real estate. In this environment, real estate could provide an inflation hedge through rising rents and appreciation. For the next few years, we look at real estate as a better tangible allocation alternative than commodities.

Investing for income in today's low interest rate environment

By Larry Adam | Chief Investment Strategist—Americas

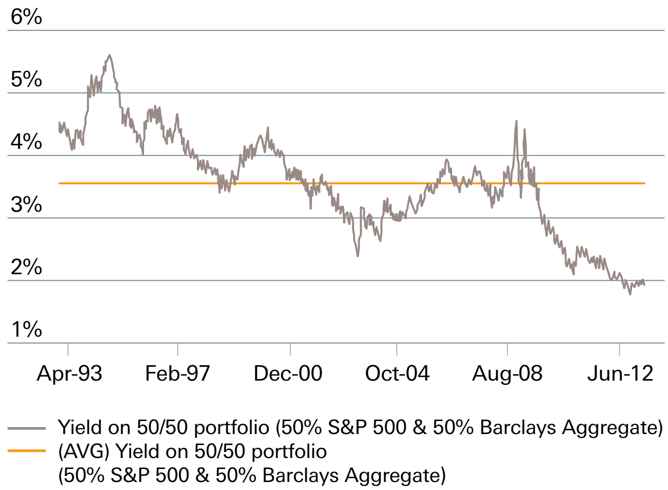
In an effort to stimulate the economy, the Fed has embarked on a third round of quantitative easing, leaving Treasury yields at historically depressed levels. As a consequence, many retirees and other income-oriented investors who have an increasing need for income have limited opportunities to generate income from traditional fixed-income securities like Treasuries.

As Exhibit A illustrates, investors with portfolios consisting of 50% stocks and 50% fixed-income securities are earning a yield of less than 2%, far lower than the 3.6% historically generated by this balanced allocation. Moreover, if interest rates rise only slightly, as we expect they might by the end of this year, investors could experience capital losses in their low-yielding fixed-income investments. Keep in mind that a 10-year Treasury bond yield only has to rise a paltry 22 bps to generate flat to negative performance for the bond over a one-year time horizon.

What options may be available to you?

Even some of the most conservative fixed-income investors have looked beyond Treasuries and investment grade corporates for higher yields that may outpace inflation. High-yield bonds, preferred stocks, master limited partnerships (MLPs) and real estate investment trusts (REITs) are a few of the income-oriented alternatives that may generate more income than the more conventional fixed-income investments.

Exhibit A
Searching for income in a low-yield environment



This decision will depend on your appetite for risk and income requirements. Yield alternatives can be categorized as income-based, equity-based and somewhere-in-between (aka hybrid). Specifically, your choices may include:

Income-Based	Hybrid	Equity-Based
Senior Loan Floating Rate Bonds	Preferred Securities	Dividend stocks
High-Yield	Convertible Securities	Master Limited Partnerships
		Real Estate Investment Trusts

Income-based alternatives

High-yield securities are technically bonds, but because they are rated below investment grade, they can be as sensitive to changing economic, market and issuer conditions as common stock.

Currently, the yield on high-yield bonds, in aggregate, offers more than three times the yield of the 10-year Treasury (5.6% vs. 1.7%)[1] with much higher coupons. So, if interest rates rise, prices of high-yield securities may fall, but the substantial coupon could help cushion the decline.

Senior loan floating rate bonds have recently yielded an average of approximately 5%, compared to 1.7% for 10-year Treasuries.[1] While these securities carry below investment grade ratings, they feature a floating rate attribute that is pegged to an index like LIBOR.[2] As a result, they may help mitigate losses in a rising rate environment.

Looking beyond traditional fixed income

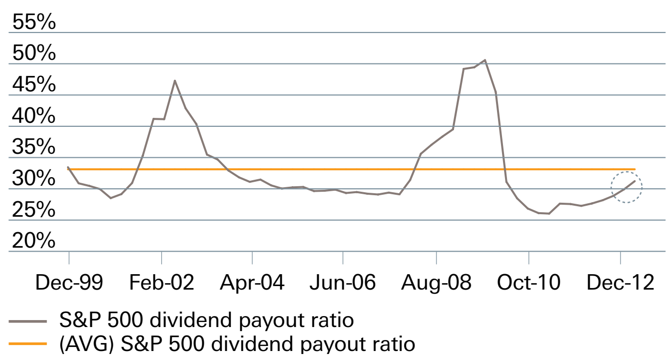
For fixed-income investors willing to look at asset classes beyond traditional fixed income, equity investments with the potential for higher relative yields may warrant consideration. Equity investments that potentially provide higher levels of income include:

Dividend stocks

Some stocks currently offer after-tax dividend yields that outpace the yield of the issuers' after-tax intermediate bond yields. This is an important dynamic as it is "cheaper" for the company to buy back their stock than pay interest on their debt. As a result, these companies are more inclined to buy back their stock, which could support the stock price. Far more important than the yield, however, is the company's ability to consistently sustain or increase dividends over time. The S&P 500 Dividend Aristocrat Index, which consists of companies that have consistently increased their dividend every year, for a minimum of 25 years, has outperformed the S&P 500 by ~3% (11% vs. 8% annually) since 1990. This outperformance is primarily driven by the fact that these companies not only pay dividends, but also consistently grow their earnings to have the ability to increase their dividends. Furthermore, there is a historical connection between growth of the dividend payout ratio and price/earnings multiples. As a company grows its dividend payout, its multiple tends to expand.

Even in today's low interest rate environment, with many investors willing to pay a premium for yield, dividend payout ratios remain below their historical averages (see Exhibit B). We believe that they have room for future growth. In addition, many companies have deleveraged over the past several years to a point where they have excess cash on their balance sheets and may be striving to readjust their capitalization rates through such equity-friendly activities as dividend increases and share buybacks.

Exhibit B
Dividend payout ratio remains below average



Master Limited Partnerships

Master Limited Partnerships (MLPs) are traded on securities exchanges like an equity, but they are structured like a limited partnership, where a general partner makes business decisions and investors serve as the limited partners.

MLPs currently offer attractive yields (the Alerian MLP Index yield was 5.4% as of April 4, 2013). They are unique in that they typically do not pay income taxes on profits, provided that they distribute at least 90% of those profits to investors. To qualify as an MLP, partnerships must derive at least 90% of their income from certain qualifying businesses, most prominent of which are oil and gas exploration and transportation.

[1] As of April 15, 2013
[2] London Interbank Offered Rate

Real Estate Investment Trusts

Like Master Limited Partnerships, Real Estate Investment Trusts exhibit low correlation to Treasuries. As a result, they may offer a degree of diversification to income-oriented portfolios, as well as higher yields than Treasury securities.

However, REITs may be a risky investment. As the article on page 7 points out, certain segments of the real estate market are at different stages of recovery. In today's environment, we would avoid segments with long lease durations like industrial and retail. It is far too easy for retailing behemoths like Wal-Mart to demand assurances that their rents not be increased for the next decade or so. Segments with short lease durations like apartments and storage facilities are our preference. With demand high and the economy growing, property owners have the ability to raise rents, thereby providing REIT investors with the potential for rising streams of income.

Hybrid investments

Convertible securities and preferred stocks share characteristics of both equities and fixed-income securities.

Preferred stock pays a fixed dividend that is paid out before the dividends paid to common shareholders. Preferred stock is often thought of as a debt instrument due to that fixed dividend, but acts like an equity due to its potential for stock price appreciation. Yields of preferred stock are currently outpacing Treasuries, where the current yield of the BofA ML Preferred Stock Perpetuals is 6.92%, compared to 1.7% for the 10-year Treasury.[3]

Convertible securities are another hybrid instrument. One of the most common types of convertible securities is a bond that converts from fixed income to common stock, where the convertible bond pays a coupon and can be converted into common stock at a specified stock price. The Barclays Convertible Securities ETF currently has a yield of 3.91% (as of April 2, 2013).

Considering new allocations to your income portfolio

While some of the investments discussed here may lie outside the comfort zone of conservative income investors, the income derived from investments in Treasuries may fall short versus historical expectations and may be negatively impacted if in fact our forecast for higher yields materializes. For those investors with a sufficiently long time frame who are willing to take on a higher degree of risk, benefits may be achieved by considering the addition of the alternatives mentioned here. In today's environment, yields that fall well short of inflation can significantly erode your purchasing power over time. Clearly, selectivity is key, no matter which investments you choose.

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[3] As of April 15, 2013

Investing in financial markets involves a substantial degree of risk. Investment losses may occur, and investors could lose some or all of their investment. Nothing herein is intended to imply that the investment instruments may be considered "conservative," "safe," "risk free" or "risk averse." The information on the benchmarks is presented for illustrative purposes only and is not intended to imply the potential performance of any investment. Benchmarks are not available for direct investment. Benchmark performance assumes the reinvestment of all distributions, but does not assume any transaction costs, taxes, management fees or other expenses. The performance of the benchmarks may vary from investments held in an account.

Is real estate poised for a triumphant return?

By Mark G. Roberts | Head of Research & Strategy for Alternatives and Real Assets

The monumental real estate collapse of 2007 and 2008 remains too vivid for many investors. Failure to consider real estate as a viable element of your portfolio, however, can leave you out of what appears to be a recovery story that has already begun.

Consider that in 2012:

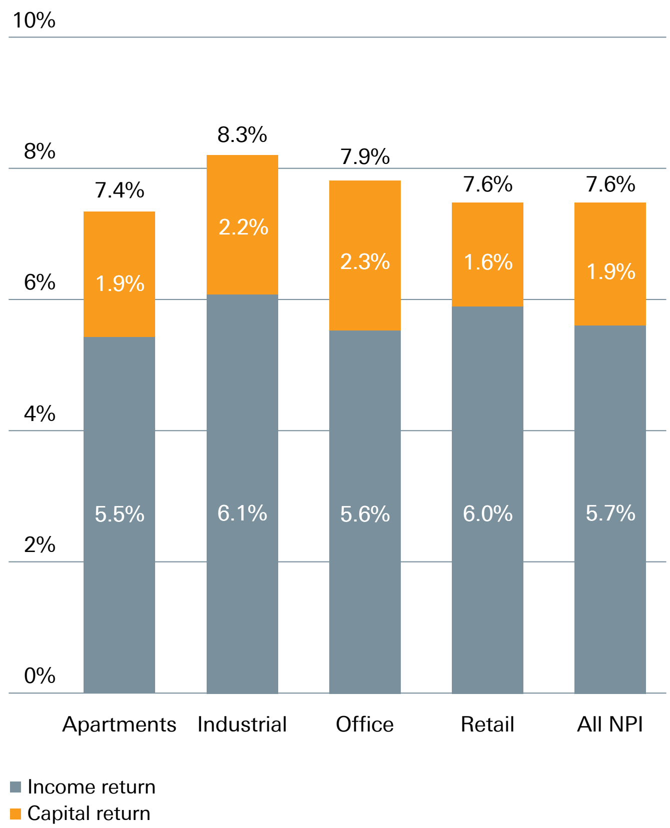
— Housing prices finally began to increase across the U.S. and supply dipped below its average of the past fifteen years;
— Apartments commanded peak rents in many key markets, while vacancies fell below their long-term average;
— Commercial real estate transaction value was 25% higher than it was in 2011, but only half of what it was in 2007;
— The spread between real estate capitalization and 10-year Treasury rates climbed to an all-time high;
— Real Estate Investment Trusts outperformed the S&P 500 for the fourth consecutive year.

So is now the time to invest in real estate?

Maybe. The flip side of all these encouraging statistics is that industrial, office and retail properties have not enjoyed the same growth as residential properties. Rents are still well below their previous peaks and vacancies are still well above average. In addition, capitalization rates stabilized but were still a bit lower in 2012 than they were the year before.

Of course, it is critical to be selective and here is what we envision for various sectors of the market over the next few years (see Exhibit A):

Exhibit A
5-year total returns forecast



Apartments

The biggest beneficiary of the real estate recovery, apartments, just completed a third consecutive year of solid rent increases. Vacancy rates are low and Generation Y (ages 21-34), the prime renting demographic group, is expected to grow by 2.4 million over the next five years.

These seemingly positive trends for continued growth, however, are tempered by several others. New construction is escalating to meet rising demand. We estimate that 135,000 units will be delivered in 2013, almost double the number completed in 2012. In addition, rising rents may well drive tenants into home ownership, especially since housing affordability continues to climb.

A mitigating factor is the tightening of lending standards for first time homebuyers. This will slow the rate of new home ownership significantly. Still, the writing is on the wall for landlords who have been enjoying the upper hand for the past few years. If you're going to consider investing in this area, be tactical in your approach and look for high quality communities in prime low vacancy markets with high demand. Currently, we believe these include: Boston, Denver, Fort Lauderdale, Orange County, San Diego, San Francisco Bay Area, Seattle and West Palm Beach. A potentially less expensive way to participate in apartments might be through what is called a "Build-to-Core" strategy. These newly constructed luxury properties are typically located in gateway and knowledge-based urban markets or selected suburbs with highly rated schools, high median home prices and proximity to mass transit.

Industrial

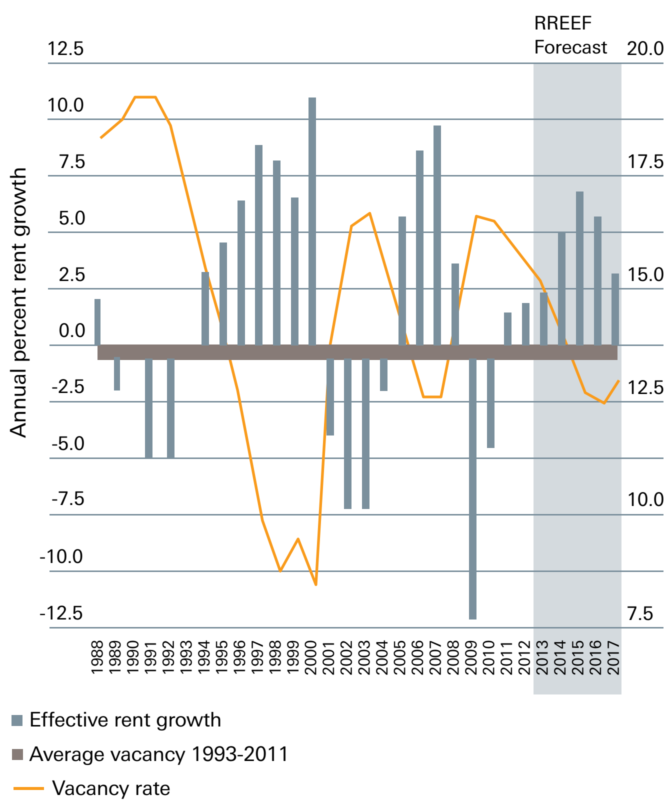
The industrial property market finished strong in 2012 with new demand up 57 million square feet in the fourth quarter. This marked the tenth consecutive quarter of positive demand. In addition, the retail vacancy rate fell 0.70% for the year, while the supply pipeline is limited.

In 2013, a recovering economy should give a boost to employment, international trade and retail spending which, in turn, should support increased warehouse demand. Look for modern functional assets in well-established global gateways and inland hubs, as well as markets dominated by industries with near-term growth prospects. These include energy, technology and medical/life sciences.

Offices are a bit more problematic. Vacancies are falling but remain near their cyclical highs (see Exhibit B). Recovery is not widespread and varies greatly from market to market. Risks to the pace of recovery include:

— Weak employment outlooks for the finance sector and federal government;
— A surplus of unused space due to employer downsizings;
— Efforts by tenants to increase space efficiency—firms leased only 80 square feet of multi-tenant space per office job added in 2012, half the long-term average space utilization of 163 square feet per office worker.

Exhibit B
U.S. office rent growth vs. vacancy



Sources: CBRE-EA and RREEF real estate
As of February 2013

Still, opportunities exist in markets with a major presence in technology, energy, education and healthcare. We believe these include Austin, Boston, San Francisco, San Jose and Houston. As companies strive to increase worker productivity and provide environments that attract good employees, locations with transportation hubs and vibrant downtown areas should become increasingly desirable.

Retail

Key economic and market fundamentals are in place to fuel at least a moderate recovery. Retailers are generally in better shape, thanks to improved sales and stronger balance sheets. Consumers, too, have improved their financial positions with lower debt and marginally higher income. Meanwhile, new supply is down as investors have chosen to use capital to improve existing properties, instead of building new ones.

At the same time, however, recovery is tepid and uneven. Leasing is just barely outpacing record low construction. And superior properties in high income, supply-constrained locations are thriving, while their weaker counterparts are experiencing store closures, higher vacancies and declines in rent. Vulnerable shopping centers are also feeling the heat from online retailing, which is transforming both consumer behavior and retail business models.

As a result, for qualified investors we advocate investment only in relatively affluent metros with the greatest constraints to supply. Most of these metros are located on the East and West Coast—New York, San Francisco, South Florida and Seattle. However, we are also encouraged by improving fundamentals in Austin, Denver and a few other growing metros. Areas to avoid include southern metros that experienced the greatest vacancy spikes and rent declines. We are also wary of assets that we consider to be vulnerable to e-commerce competition. These include power centers and commodity retail space in non-prime locations.

Participation alternatives

Investors wishing to participate in real estate have a number of choices available to them.

One avenue for investors with the necessary expertise is to purchase properties on their own. Or sophisticated real estate investors can participate in limited partnerships or joint ventures that acquire and manage apartment complexes, shopping malls and other real estate. Often, this approach employs leverage that can boost potential returns but not without involving considerable risk. Private real estate investing typically requires a substantial capital outlay. In addition, liquidity is extremely limited and your assets may be tied up for a long period of time.

For many individual investors, Real Estate Investment Trusts (REITs) may be a simple way to add real estate to an investment portfolio. REITs are managed by professionals and offer property diversification. In addition, publicly traded REITs may be bought and sold like a stock, so there is the potential for ready liquidity.

In 2012, the REIT sector, as measured by the National Association of Real Estate Investment Trusts (NAREIT) Index, returned 19.7% versus 10.9% for the private real estate market (as measured by the National Council of Real Estate Investment Fiduciaries Open-End Core Diversified Equity Index). However, private real estate typically lags REITS by 3–4 quarters. We believe that the favorable cost of capital and improving property fundamentals will enable REITS to continue generating low double-digit returns in 2013. The positive momentum in the public markets also bodes well for private markets.

Investing in real estate and REITs involves risk and is only suitable for persons who can afford to sustain a significant loss of their investment. As with any investment, investors should take into account their own financial situation, consult their financial adviser and perform thorough research before making any investment decisions concerning REITs or real estate.

Is estate planning still relevant after ATRA?

By Blanche Lark Christerson | Senior Wealth Planning Strategist—Americas

The American Taxpayer Relief Act of 2012 (ATRA) was enacted on January 2, 2013. It resolved part of the so-called "fiscal cliff" by permanently extending the expiring tax cuts from 2001 and 2003 for most taxpayers, while raising taxes on the top 1% to 2%.

It also brought stability to estate, gift and generation-skipping transfer taxes by permanently extending provisions that were enacted in late 2010—provisions that will progressively exempt more and more taxpayers from the transfer tax system. To understand what this means, some background may be helpful. In addition to preventing across-the-board tax increases in 2013, ATRA prevented transfer taxes from reverting to what could be viewed as confiscatory levels: $1 million transfer tax exemptions, and a top rate of 55%. In other words, although ATRA raised the top rate from 35% to 40%, it permanently continued the generous provisions that began in 2011 and that would have expired in 2013: the $5 million applicable exclusion amount (AEA), and "portability."

The applicable exclusion amount protects taxable transfers from gift and estate tax; the generation-skipping transfer tax (GST) exemption equals the AEA, and protects transfers to people such as grandchildren (either outright or in trust) from GST. Thanks to inflation-indexing, the AEA was $5.12 million in 2012, and, in 2013, is $5.25 million.

"Portability" refers to the surviving spouse's ability to effectively "inherit" the deceased spouse's unused AEA, provided that the deceased spouse's executor files an estate tax return and makes the appropriate election (this is required even if the deceased spouse's estate is under the filing threshold—$5.25 million in 2013). The surviving spouse can use that extra AEA for gift or estate tax purposes.

To illustrate, if Husband dies on January 1, 2013, and Wife receives his unused $5.25 million exclusion, she can protect a total of $10.5 million in 2013 from gift or estate tax (assuming she hasn't used up any of her own AEA). In subsequent years, Wife will be able to protect even more property from gift or estate tax: although her inherited AEA from Husband is frozen, Wife's own AEA will grow because of inflation-indexing.

The ability to protect such significant amounts of property from transfer taxes—even if someone is not married and can't "double up" on the exclusion—raises the following question: Is estate planning still relevant? After all, historically, the goal of planning has been to create various structures to mitigate the impact of transfer taxes and preserve as much wealth as possible for the family unit. If transfer taxes are less of an issue, why plan?

For example, a typical structure for married couples would have gone like this: If Husband died first, his will created a "credit shelter trust" for Wife and Children; the balance of his property would pass to Wife, either outright or in trust (Wife's will would have similar provisions). The trust would equal the amount of property Husband could protect from federal estate tax. At Wife's death, the trust would pass, estate-tax free, to Children. Such a trust was necessary, because if Husband simply gave everything to Wife, the marital deduction would apply and trump his exclusion amount, thereby wasting it. On its face, portability makes such a trust unnecessary. But is that actually the case?

That depends. Keep in mind that neither the GST exemption nor any state estate tax exclusion amount is portable. In other words, for example, if Husband and Wife are wealthy enough to afford to benefit multiple generations of descendants, they need planning to take advantage of both of their GST exemptions—otherwise, the likelihood is that one of those exemptions will be wasted, and less property will be protected from GST for future generations.

Similarly, suppose that Husband and Wife live in a "decoupled" state with its own estate tax, such as New York, New Jersey or Massachusetts. If Husband simply leaves everything to Wife, portability will give his unused federal applicable exclusion amount to Wife, but not his unused state estate tax exclusion. If Husband doesn't use that state exclusion at his death, it dies with him, and unnecessary state estate taxes may be payable at Wife's death if she still resides in the decoupled state. Married couples in decoupled states who wish to minimize their potential state estate tax exposure are therefore not exempt from estate planning concerns.

A related issue is the following: Suppose that Husband and Wife live in decoupled New York, which only has a $1 million estate tax exclusion. They haven't updated their wills for a long time, because they kept waiting for Congress to do something permanent about the estate tax. Thus, their "vintage" wills create credit shelter trusts equal to the maximum amount they can protect from federal estate tax. Now that ATRA is in place and the $5 million exclusion is permanent, they figure it's time to see their estate planning lawyer. Before they get there, however, Husband dies. He has a $10 million estate, and Wife survives him. Husband's credit shelter provision triggers over $400,000 of New York estate tax. Ouch. The moral of the story is that married couples who live in decoupled states should revisit their planning documents to make sure they still work, given the ever-growing disparity between the decoupled state's exclusion amount and the increasing federal exclusion amount.

Single individuals are less likely to have formula clauses in their wills that reference an amount that can be protected from federal estate tax. Nevertheless, it is also a good idea for them to revisit their planning documents to make sure they still accomplish desired goals. But given how much property a single person can leave to heirs without incurring federal estate tax, is planning still relevant? Yes. Individuals need something as basic as a will, for example, unless they are content to let their property pass pursuant to state law, which would generally benefit children, parents or siblings—but certainly not a "significant other" or dear friend. Indeed, unless the Supreme Court strikes down the Defense of Marriage Act, which defines marriage as between a man and a woman, same-sex couples who are legally married in a given state are treated no differently, for federal tax purposes, than complete strangers, and could face significant federal (and state) estate tax issues, depending on their level of wealth. Thus, planning documents such as wills (or revocable trusts, which can serve as will substitutes) are still necessary. What about trusts, however, which are frequently used to achieve various tax benefits? Why bother with them if taxes are less pressing?

It is worth remembering that trusts offer more than just tax benefits: they can help protect an improvident heir from himself, or can offer a beneficiary creditor protection, while still permitting liberal access to trust principal. Or—and here is the unvarnished truth about many trusts that provide for surviving spouses—they can guarantee that after the surviving spouse's death, property passes according to the first spouse's wishes. This matters in a second marriage, or even in a first marriage. For example, Husband might be concerned that Wife could be a "soft touch" for her younger, ne'er-do-well brother, at the expense of their children; Wife might be concerned that if Husband survived her, he would remarry and start a new family—what would then happen to her children's inheritance? In both of these scenarios, Husband and Wife want to ensure that the other is well taken care of, but also want to ensure that property passes to their children when the survivor dies.

So what basic point can be drawn about post-ATRA planning? That it is still relevant. Although the federal estate tax will be increasingly less of a concern for many—assuming, of course, that Congress doesn't change its mind about the generous "permanent" $5 million applicable exclusion amount—planning documents are still necessary. They also need to be revisited to make sure their desired objectives are accomplished, and that those objectives are not inadvertently thwarted by the significant exclusion amount.

For comments, questions or suggestions, please e-mail: uspwm.editorialteam@db.com

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