105 S. York St, Suite 450
Elmhurst, IL 60126
Voice: (630) 530-1191
Fax: (630) 530-1442

MENTOR
CAPITAL

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Wealth Management Team: John Davis, CFP - Dan Carey, CFP **Administrative Staff:** Tammy Prim

Mentor Monthly Missive

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- Estate plans – what everyone should know
- Passive vs. active
- Is your living trust complete?

Are we ready and prepared?

In this month's newsletter, we focus on the important issue of estate planning. An estate plan – basically a series of documents outlining steps to be taken when a person dies or is incapacitated – is a vital part of an individual's overall financial plan, but often the most overlooked.

The cost of creating an estate plan, along with uncertainty that has resulted from the government's inability to agree on long-term tax and estate legislation, have caused many to procrastinate about estate planning. This lack of execution and confusion could end up costing families money and heartache.

From a financial planning point of view, here are some essential elements of a sound estate plan:

1. No matter you're worth, it's important to have a basic estate plan in place. Such a plan ensures that your family and financial goals are met after you die.

2. An estate plan has several elements. They include: a will; assignment of power of attorney; and a living will or medical power of attorney. For some people, a trust may also make sense. When putting together a plan, you must be mindful of both federal and state laws governing estates.

3. Taking inventory of your assets is a good place to start. Your assets include your investments, retirement savings, insurance policies, and real estate or business interests. Ask yourself three questions: Whom do you want to inherit your assets? Whom do you want handling your financial affairs if you're ever incapacitated? Whom do you want making medical decisions for you if you become unable to make them for yourself?

4. Everybody should have a will. A will tells the world exactly where you want your assets distributed when you die. It's also the best place to name guardians for your minor children and their assets. Dying without a will, also known as dying "intestate" can be costly to your heirs and leaves you no say over who gets your assets. Even if you have a trust, you still need a will to take care of any holdings outside of that trust when you die.

5. Trusts aren't just for the wealthy. Trusts are legal mechanisms that let you put conditions on how and when your assets will be distributed upon your death. They also allow you to reduce your estate and gift taxes and to distribute assets to your heirs without the cost, delay and publicity of probate court, which administers wills. Some also offer greater protection of your assets from creditors and lawsuits.

6. Discussing your estate plan with your heirs may prevent disputes or confusion. Inheritance can be a loaded issue. By being clear about your intentions, you help dispel potential conflicts after you're gone.

7. The federal estate tax exemption, which is the amount you may leave to heirs free of federal tax, changes. The estate tax hit $3.5 million in 2009, but was phased out completely in 2010. Unless Congress passes new laws between now and then, the tax will be reinstated in 2011 at $1 million.

8. You may leave an unlimited amount of money to your spouse tax-free, but this isn't always the best tactic. By leaving all your assets to your spouse, you don't use your estate tax exemption and instead increase your surviving spouse's taxable estate. That means your children are likely to pay more in estate taxes if your spouse leaves them the money when he or she dies. Plus, it defers the tough decisions about the distribution of your assets until your spouse's death.

9. There are two easy ways to give gifts tax-free and reduce your estate. You may give up to $13,000 a year to any individual

(or $26,000 if you're married and giving the gift with your spouse). You may also pay an unlimited amount of medical and education bills for someone if you pay the expenses directly to the institutions where they were incurred. Charitable gifts also reduce your taxable estate.

10. Other areas to consider: Do I need a trust? Is my trust funded? Do I have a succession plan in place for my business? Should I prepare a buy/sell agreement with my business partner? Do I need a business valuation?

Feel free to contact us with any questions regarding your current estate plan.

Passive beats active investing again

An awful lot of people spend an awful lot of time and make an awful lot of money picking stocks for actively managed mutual funds. One would think that with all those brains and hard work involved, the result would be consistent outperformance relative to market indexes.

Unfortunately, it's not the case. Most times, active fund management results in underperformance against relative indexes. The point was driven home during a recent presentation by a portfolio manager for Ariel Investments.

Ariel's Ariel Fund is an actively managed mutual fund established in November 1986. Although the fund has had superior performance during some periods of its history, it has also had periods of exceedingly poor performance. For example, in 2000, the fund's total return was 28.77%. That put it in the top quartile of similar funds. In 2008, the fund lost 48.25%, which was among the poorest-performances of similar funds.

A patient investor who held the Ariel Fund for 15 years ending Sept. 30, 2010, would have lagged the return of the Spider S&P Midcap 400 exchange traded fund (a passive fund that tracks Ariel's benchmark index) by 0.48% per year – a difference of $10,744 on a $10,000 initial investment. In addition, many investors don't have the stomach to stick around when a fund loses almost half its value in one year; many others pile in when a fund does well. Fund volatility leads investors to act in a way that's not necessarily in their best interests.

Investors who are comfortable with consistent returns that match the relative indices will fare better buying passive, low-expense funds and holding them through thick and thin.

Living trust? Don't forget your home

Establishing a living trust is a common way to pass assets on to heirs economically and efficiently. Many who establish such trusts also transfer ownership of their personal residences to the trust.

Once a deed is filed naming the trust the property's new owner, there is still an important step to take: Naming the trust and the trustee as additional insureds in the homeowner's insurance policy. Without taking this step, property and liability coverage on the home can be rendered useless.

If you've transferred ownership of your home or other real estate to a trust, contact your property and casualty insurance agent right now to make sure the trust and trustee are included in the policy as named insureds.

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