



A WEALTH ADVISORY NEWSLETTER FROM HTG INVESTMENT ADVISORS

# GLOBAL INVESTING: *Finding the Optimal Allocation*

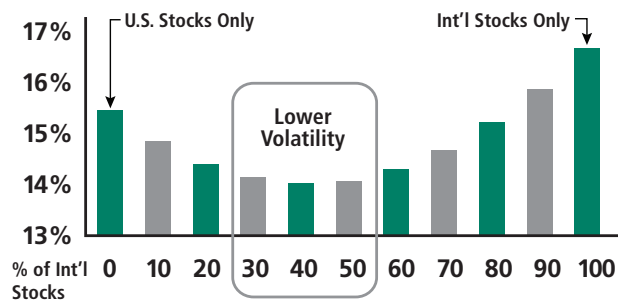
Investing internationally is well accepted by investors as a way to provide portfolio diversification. As globalization gains momentum, it is widely believed that all equity markets will become increasingly correlated. Historically, the returns and volatility from US and foreign stocks have been similar. Despite this, past data shows that a combination of US and non-US stocks produced better risk-adjusted performance because the returns, while similar in size, were earned at different times. But, if correlations are increasing as global economic and financial integration accelerates, what should we conclude about the value of global investing?

We believe that venturing abroad continues to be compelling, though the reasons for doing so are changing. According to reports from JP Morgan, US equities represent only 42% of worldwide equity value. Europe accounts for 31%, Japan 9%, other developed countries 7%, and emerging markets 11%. By removing country boundaries, investors are free to seek the best companies within an industry regardless of home country. In addition, we expect the investment markets of develop-

ing countries to grow at twice the rate of developed countries. This expectation is based on their high GDP growth, a culture of savings, rising foreign exchange reserves, improving corporate balance sheets and strong demand for exports. We also see evidence that stocks of small companies overseas continue to have lower correlation to large company stocks, because their business tends to be more country and regionally based.

### The Sweet Spot in a U.S./International Portfolio

Annualized Risk Level



Source: Alliance Bernstein

International investing may also protect us from declines in our own currency, such as the dollar's recent 30% drop. But we must be wary of the impact of currency changes, because they work both ways. Historically, currency values tend to move in long cycles and tend to track long-term inflation trends. When a

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# TAX INCREASES AHEAD?

## *Time to Tune Your Portfolio!*

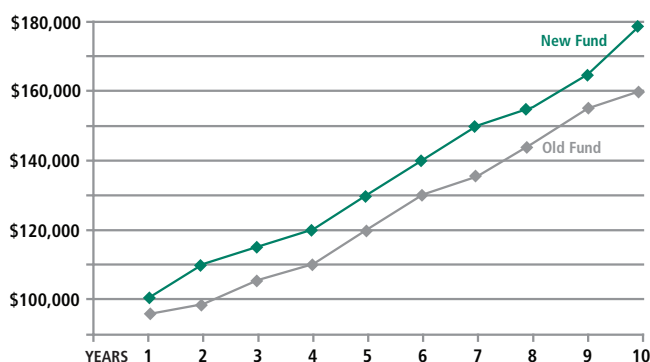
Future tax rate increases favor acceleration of capital gains.

The large Federal budget deficit and shifting political winds are greatly increasing the likelihood of changes in US tax rates, possibly as early as 2009. Most proposals call for an increase in the maximum capital gains rate from 15% to 20% or even 28%. If you believe that such an increase is imminent, what should you do?

One suggestion is to use the prospect of higher taxes as a catalyst to restructure and improve your taxable portfolio. First, sell securities to reduce a risky concentration in a single stock or market segment. Second, consider rotating assets out of current holdings when you see alternatives with better prospects. Finally, rebalance your portfolio by selling assets that have appreciated so that they are not over-weighted compared to your target asset allocation.

Below, we provide an example to aid in understanding this complex subject. This example is not intended to apply to all situations. Assumptions and facts will be different in each case and can have a material impact on the outcome. However, we believe that this approach can be used as a framework for considering portfolio changes.

Old Fund versus New Fund



Assume that you have a mutual fund holding (“Old Fund”) with a current market value of \$100,000. Your original purchase cost was \$50,000. Congratulations! Your investment is worth twice what you paid for it.

However, now you would prefer to be invested in a different fund with even better prospects (“New Fund”).

You believe that New Fund will outperform Old Fund by at least 1% over the long term. You would like to make the switch, but you know that by doing so, you will realize a \$50,000 capital gain and pay a tax of \$7,500 (assuming a capital gain tax rate of 15%).

That makes no sense, right?

Well, maybe it does make sense! If you believe that the capital gains rate is going to increase from 15% this year to 20% next year, you are better off making the change this year. Let’s look at this set of assumptions:

Current Value = \$100,000  
Cost Basis = \$50,000  
Capital Gains Tax Rates:  
Today = 15% | Future = 20%  
Expected Annual Return:  
Old Fund = 7% | New Fund = 8%  
Expected Holding Period = 5 years

If you sell Old Fund today, your after-tax proceeds will be \$92,500. If you reinvest the proceeds into New Fund, its value at the end of five years will be \$135,913. When you sell New Fund, you will pay capital gains tax on the earnings for the past five years, and your after-tax value will be \$127,230.

However, if you decide to keep Old Fund and then sell after five years, its value will be \$140,255. After paying taxes on the realized gain, the after-tax value will be \$122,204.

As a result, the increase in future value realized by making the shift to New Fund today is \$5,026. The benefit continues to increase as your holding period increases, as illustrated in the graph. By the end of ten years, the improvement in future value increases to \$10,888.

By considering additional examples, we find that the benefits of making such changes exist even without an increase in the capital gains tax rate. In many cases, as long as you believe that New Fund will outperform Old Fund by

at least 1% per year, the change is justified even if the tax rate remains constant.

Managing risk and enhancing future after-tax value are important goals. The analysis summarized above demonstrates the value of letting good investment decisions lead the wealth management process. While we believe that you do not necessarily need prospective increases in tax rates to justify making improvements to your portfolio, the current tax outlook may provide an added incentive to those who might otherwise be reluctant to make such changes. ♦

#### **BREAKTHROUGH IN WEALTH MANAGEMENT: AUTOMATED DATA RETRIEVAL**

As families succeed at accumulating wealth, it is not uncommon to have numerous investment accounts situated at several financial institutions. To promote effective asset allocation, diversification, risk monitoring, cash flow planning, and tax management, it is critical that your advisor be able to view all your accounts. Until recently, HTG was receiving data daily only from Charles Schwab and Fidelity, making the process of managing assets scattered at many custodians cumbersome.

We are delighted to report that we now have the technology to electronically receive data daily from most brokerage, mutual fund, retirement plan and college savings plan websites, making it possible for us to include all your accounts as part of our comprehensive investment management service.

#### **INDEPENDENT CORPORATE TRUSTEE SERVICES**

**There are two broad categories of services that a trust needs: Investment Management and Administration.**

We are pleased to announce that both Charles Schwab and Fidelity have recently expanded their product offerings to include independent corporate trust services. This unbundling of corporate trust services means HTG can now provide investment management services for your trust assets, while Charles Schwab or Fidelity acts as institutional trustee providing the administrative trust services of record keeping, tax preparation, and distribution oversight. We look forward to this expansion in the scope of wealth management services we can now offer to our clients.

## **HTG RECEIVES AWARD**



### **New Canaan Volunteer Business of the Year**

HTG Investment Advisors Inc. received the Business of the Year Award at New Canaan's Volunteer Recognition Day on April 22, 2008. The award is presented annually by the New Canaan Volunteer Center, which forms partnerships between volunteers and a range of non-profit organizations to improve the quality of life in New Canaan.

HTG was cited "... for its longtime partnership with the town as community leaders, arts patrons, and philanthropists."

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## *Global Investing...*

currency moves against an investor, the impact can be severe. For example, over the past five years, a European investor who diversified in a global market-cap-weighted portfolio earned only 0.4% per year in Euros while a US investor who held the same portfolio earned 9.0% in dollars. US investors should keep in mind that their future living expenses will be in dollars, which is a significant reason to limit currency risk.

We believe that global portfolios offer a far greater set of opportunities than a strictly domestic portfolio. So, the question is: "What amount of an equity portfolio should be allocated to international equities?" Standard financial theory suggests an allocation based on market capitalization in keeping with the concept of an efficient market. Although the market-cap indexing approach is simple and is easy to understand and implement, it may result in too great a concentration in one country or region. This was the case in the late 80s when Japan's equities became seriously over-valued and represented a disproportionate percentage of the world's market. Moreover, investing outside the US carries higher costs, tax liabilities, political risks, and information limitations. Finally, some markets are simply not fully open to foreign investment and others do not have strong legal protections for shareholders.

The market and currency issues cited above provide good reasons for US investors to invest more at home than would result from the global market-cap-weighted allocation suggested by efficient market theories. However, we do not believe these reasons justify the extreme home-country bias exhibited by US investors historically. (US individuals investment in overseas equities was less than 10% as of 2005 and remains below 20%.)

Historical evidence shows that a portfolio with 30% to 50% in foreign equities provided comparable returns, while incurring less risk, than a 100% US or 100% foreign portfolio. We are inclined to moderate that range somewhat for the "home-bias" reasons discussed above. We believe that an exposure in the range of 25% to 40% in foreign equities is reasonable at the present time. We favor allocating about half of the international equity to emerging markets and small company stocks. The remainder can be diversified among the most attractive large companies based in the major developed markets, without setting limits by country. ♦

- ◆ Tom and Jeanne Gnuse attended the annual meeting of the Aegis Group, held at the offices of South Texas Money Management, Ltd., in Austin, Texas.

Aegis is comprised of twelve members who are the managing principals of financial advisory practices from across the country.

These annual two-day meetings focus on a broad range of issues that impact the management of a financial advisory business.

- ◆ Barbara Ollinger and Jennifer Nicasio attended the annual conference of the Connecticut Financial Planners Association in April. Topics discussed included estate planning, global investing and the current real estate market.

- ◆ We are pleased to welcome Susannah Hansley to our HTG family. Susannah will be happy to greet you when you call or visit our office. She comes from Northwestern Financial Network where she was a financial representative for four years servicing client insurance and investment needs. She has two daughters, aged 24 and 17, and has lived in New Canaan for 12 years.



- ◆ HTG hosted an evening at the Powerhouse Theater in New Canaan where we saw Tom Butterworth star as Inspector Goole in the production “An Inspector Calls”.

- ◆ We all wish Emily Ziolkowski, daughter of Robin Sherwood and Andy Ziolkowski, congratulations as she graduates this May with a B.A. in Asian Studies from Colorado College.
- ◆ HTG is celebrating our fifteen year anniversary. We will be honoring two of our favorite charities at an event in the fall. Keep an eye out for further information on our anniversary celebration.

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We would be happy to add family members or friends to our newsletter mailing list. Please call or email Jennifer at (203) 972-8262 or [jennifer@htgadvisors.com](mailto:jennifer@htgadvisors.com). Also, please let us know if you're interested in receiving your newsletter by email.



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