



## Investing in Foreign Bonds

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Many of our clients may have noticed some unfamiliar bonds in their portfolios. Among the familiar Federal Home Loan Bank and U.S. Treasury bonds that some clients currently own, they now see bonds from Australia, New Zealand and perhaps Canada as well. So what are these and why have we purchased them?

Where appropriate, we have started purchasing International (foreign) bonds in order to provide additional diversification and protection against any singular issuer or currency. International bonds come in similar varieties as those of their U.S. counterparts. Most foreign governments have a finance department analogous to the U.S. Treasury and they issue bonds just as they do in the U.S. These government bonds, known as Sovereign bonds, resemble any other bond; they pay interest at regular intervals and at maturity, they pay the principal amount back to the owner. Most of these bonds are denominated in the currency used by the country that issues them. For instance,

the Australian bonds that we purchased are denominated in Australian Dollars.

With international bonds, there are two major reasons why their prices will rise or fall. First, just as domestic bonds are affected by the Federal Reserve's adjustments of interest rates; foreign bonds rise or fall in value as interest rates in a particular country change. Second, for international bonds that are denominated in a foreign currency, changes in the exchange rate for that currency can have a pronounced effect on bond prices. As an example; since we first purchased the Australian bond, the Australian Dollar has appreciated versus the dollar, inflating the value of the bonds.

So why are we purchasing foreign bonds for our clients?

The U.S. fixed-income market is the most dynamic and liquid securities market in the world.



However, the growth in the U.S. federal debt coupled with the threat of higher U.S. interest rates in the future make the fundamentals in the U.S. market less compelling. Since economic and business cycles around the world do not move in the same pattern, a portfolio that also contains foreign bonds can provide investors with diversification and reduced risk in the face of a worsening domestic economic environment while providing opportunity to invest in potentially more attractive foreign markets.

For instance, developing Asia, which includes New Zealand, is projected to eclipse the United States, Japan and Europe as the chief contributor to global growth over the next few years. By purchasing bonds issued by countries located in this region of the world, portfolios can capitalize on this growth potential.

#### And what about the currency effect?

The potential for further dollar weakness exists as higher inflation expectations and increased U.S. Government debt levels contribute to a weaker environment for the dollar. A portfolio containing international bonds denominated in foreign currencies can help protect the purchasing power of U.S. based investors during these periods, as the value of many foreign denominated bonds rises in dollar terms.

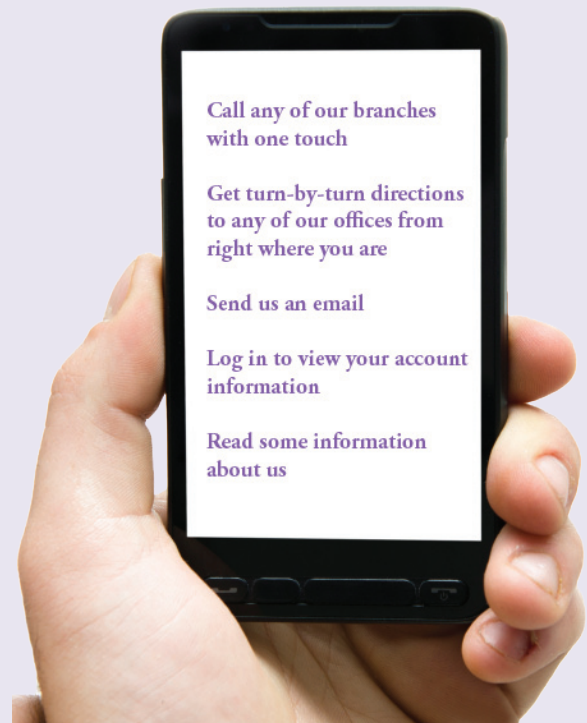
At this point, we are limiting our individual bond purchases to those countries with stable governments and excellent credit quality. We are also using exchange traded funds (ETFs) that invest in fixed income issued by developing Asian countries as well as Emerging Market countries.

We believe that the addition of non-U.S. bonds, including those from both developed and emerging markets, may help increase returns and decrease overall portfolio risk. With this approach we can take advantage of a larger universe of securities to choose from, attractive risk/return characteristics, and improved diversification. By doing this, clients may be better positioned to meet their long term financial goals.

## Have an iPhone or Android?

### A TCV App is Coming!

Our app won't play games, show movies or some of the other flashy things apps can do, but it will let you:



If you have ever experienced how clunky it can be to navigate a regular website on the small screen of a smartphone, this app is for you!

It is on the Android marketplace now and we hope it will soon be on Apple iTunes.

It's free....just search for "TCV".

We hope you find it useful.

# STEAM

Jack Davidson



Shortly after retrieving her Prius from the dealership after a routine oil change, my wife noticed that the oil light had come on. She pulled over, checked the oil, discovered she had none and called the dealership. Fortunately, she had only travelled several miles and had driven slowly enough so that she was running on the battery rather than the pistons. It turns out that hybrids not only save gas, they can save oil as well.

The tow truck arrived, driven by a nineteen year old, and Judy was wondering to herself if this teenager would know the correct way of towing a hybrid. He certainly did. As they were driving back to the dealer, she explained the circumstances to him. She was beginning to build up a head of steam, likely to be vented at the dealership, due to worry about the car and her need to be back in Brattleboro by a certain time. That is, until she encountered the wisdom of the nineteen-year-old who simply commented, “people are human.” The steam stopped. The day ended well.

People are human. This certainly includes spouses and children. Sometimes their behavior creates enough steam to break a relationship or push a client to revise their Will or Trust. Sometimes we need the wisdom of this nineteen-year-old boy to ultimately do the right thing.

Steam is not necessarily a bad thing. We frequently need it to finish an estate plan. That said, our job as

estate planners is to look into the future and address “what-if” scenarios. When we do, there is a real risk that our clients will run out of steam. The irony is that the steam that seems to have the most lasting energy is the one generated by the negative behavior of our intended beneficiaries.



In estate planning, the challenge is to look at the dark side without the dark side taking over the process. Yes, we know people are human, and yes, we know that people will change, but do we truly incorporate this knowing into our estate plans?

I recently dealt with a trust beneficiary, now in his fifties, who has to come to us to seek approval for principal invasions because of the provisions of the trust. The trust was created by a relative when the beneficiary was a young man. This beneficiary is now an adult more than able to take care of his financial needs. He does not need us to stand *in loco parentis*, and I suspect that the trust, created by a well-meaning relative, is a continual source of tension if not humiliation. Who knows whether thirty years ago, when the trust was created, if the relative and the attorney spent much time thinking about the long-term impact of restricting the young man’s access to the funds?

I have reviewed many trusts with provisions that, upon the untimely death of a child, will continue for the benefit of the grandchildren until they reach adulthood. The child's spouse, more often than not, is excluded. Whenever I consider the pros and cons of whether to include a spouse, I recall the feelings of a friend who related an instance of family picture-taking. At the request of his mother-in-law, he lined up his wife and son next to her and the Christmas tree. He used a tripod, and once satisfied with the composition, rushed to get into the picture only to encounter, "No, no, no, I just want blood relatives." He long ago let off the resultant steam ~ or did he?

Today's hybrid cars are engineering marvels and a legacy of earlier efforts to produce efficient cars. In 1926, Howard Hughes enlisted two Caltech graduates in an effort to build a steam-powered car which would be practical enough for general use. Upon inspecting



the finished product – a five-passenger, open-top touring car – he asked the engineers how they solved the water storage problem. They explained that the radiators were hidden throughout

the body, including inside the doors. When asked by Howard what would happen if someone hit the car broadside, they had no response.

"I'd get scalded to death ~ right?" he asked.

"It's possible," said one of the engineers.<sup>1</sup> Hughes scrapped the project.

Our goal in estate planning is, in part, not to build up

unintended steam. We can hide it, but we worry if our plan will ever be hit broadside.

## Divorce

Looking back at the many estate plans that I have been part of, I do not recall raising this issue directly. Perhaps I should have, but for the most part I find that spouses appear to be keenly aware of the level of probability for themselves, and I only need to be circumspect. I do, however, bring up the estate-planning risks of second marriages upon the first spouse's death.

Fortunately, my role, along with others like myself at the Trust Company, is secondary to that of the attorney. We assist in the estate planning process for our clients and individuals who plan on naming us as trustee (or in a support role to family members who will be acting as trustee). We do so without charge and hope that mentioning "what-if" scenarios assist the overall process. We also strive to become educators who can translate the legalese. We play this role knowing that the attorney has the final say.

That said, when we get involved in suggesting a division of assets as part of the planning process, we may be affecting spousal interests upon divorce that have not been addressed by the attorney. Fortunately, Vermont is a state that grants the court the authority to ignore actual title in splitting assets upon a divorce, or so we think, but this may not be the case if the client moves out of state.

When clients tell me that upon their deaths they would like to leave their property to their children at age 21, I usually respond with the suggestion that they may want to consider distribution in stages (ages 25, 30, and 35 for example).

Should I bring up the impact of divorce? Statistics on the national divorce rate vary from 40% to 50%.



Researching the matter further, I have discovered more complex statistical phenomena. The divorce rate is much lower if our children are over 30 when they marry. And it is lower in the Northeast, with Massachusetts probably averaging the lowest divorce rate in the country. I also discovered that children with happy childhoods may have a higher divorce rate than the norm, which didn't seem to make much sense, and that divorce rates in Egypt are highest in families where the men are avid soccer fans, which did (and I suspect that if we didn't have the Red Sox and the Patriots, the divorce rate in Massachusetts would be non-existent).

Although there was a recent case in Vermont that startled a few attorneys<sup>2</sup>, for the most part trusts can be designed to protect assets from a divorce, but at a price. The price in part is the cost of maintaining a trust. It may also be the cost of subjecting a child to the “parental” oversight of a third party. Your legacy may be steam that keeps on giving.

If a child's share is to be held in trust for a period of time that may be as long as his or her lifetime, the planning becomes complex. Family members may be appropriate trustees, but the tax implications are complicated and perhaps challenging for the attorney. Corporate trustees, such as our Trust Company, can absorb some of the family tension or shield a family member who is co-trustee from the distasteful task of turning down a request. Corporate trustees can also add to the tension. Our experience tells us there are no hard and fast rules, with perhaps one exception ~ don't make the second spouse trustee of a trust for the children of a previous marriage.

## The Trust Protector

One recent development in the estate planning field is the use of a trust protector. We see more attorneys incorporating trust protector powers which would allow a third party to adapt the trust to changing circumstances such as early termination of the trust if a child becomes a responsible adult or the trust is no longer needed to protect assets from the impact of a divorce.

The trust agreement sets forth the dual functions of the Trustee and the Trust Protector. While the Trustee can be a bank or trust company, or other financial institutions, the Trust Protector is usually a person close to the family: a CPA, accountant, or attorney.

We encounter clients who have close relationships with their accountants and attorneys. In some instances, clients would like to use them as trustees, but Vermont law does not permit a lawyer or accountant more than five unsolicited appointments.<sup>3</sup> The law, however, does not appear to bar them from being a Trust Protector.<sup>4</sup>

We often associate steam engines with railroads. Historically, the two most important players on a train are the Engineer, who operates the train, and the



Conductor, who is responsible for operational and safety duties that do not involve the actual

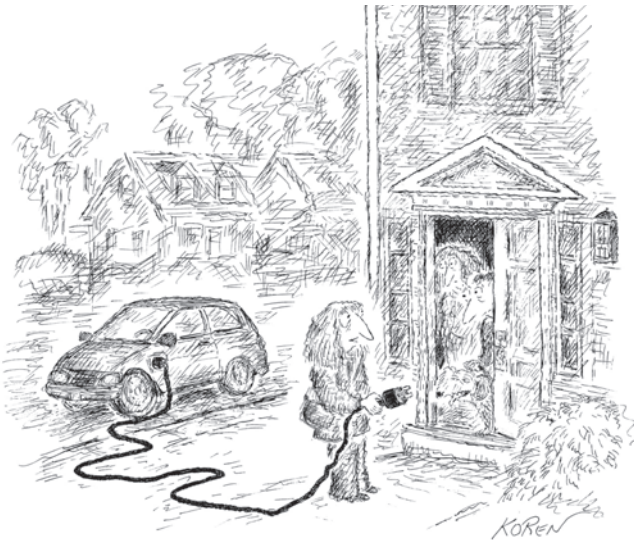
operation of the train. You might look at the Trustee as the Engineer for your plan and the Trust Protector as the Conductor. It's the Engineer's role to invest the trust assets, make the invasion decisions, do the tax returns and follow the fiduciary accounting rules. It's

the Conductor's role to control the steam, whether it comes from trust provisions that have outlived their usefulness, trustees who are unresponsive, or responsible adult children who wonder why your plan was so inflexible.

If you are interested in incorporating a Trust Protector in your plan, see our checklist for your use when you next visit with your attorney.

**Notes:**

1. *Howard - The Amazing Mr. Hughes* by Noah Dietrich
2. *Chilkott v. Chilkott*, 158 Vt. 193, 607 A.2d 883 (1992)
3. 8 V.S.A. § 2402 (11) (B)
4. 8 V.S.A. § 2402(f)



*"I'm only a few miles from home. Could I borrow a socket?"*

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## Trust Protector Checklist

Trust Protectors can be given one or more powers to amend your trust, or control a trustee, or to change the disposition of your property or the handling of your assets, as specifically authorized by statute.

Here's a checklist:

The power to amend the trust to:

- achieve favorable tax status,
- respond to changes in the tax law or take advantage of changes in trust law,
- and to change the governing state law;

Powers over the trustee or a trust protector to:

- approve a trustee's accountings,
- remove a trustee and appoint a successor,
- consent to a trustee's action or inaction in making distributions to beneficiaries,
- perform a specific duty that would normally be required of a trustee,
- advise the trustee concerning any beneficiary,
- appoint a successor trust protector
- to remove and replace a trust protector;

Powers that will affect the disposition of your property:

- increase or decrease any interest of the beneficiaries in the trust,
- grant a power of appointment to one or more trust beneficiaries,
- terminate or amend any power of appointment granted in the trust (subject to certain restrictions);

Powers over trust assets:

- to consent to a trustee's action or inaction relating to investments of trust assets,
- to direct the acquisition, disposition, or retention of any trust investment.

See 14aVSA § 1101 for specific detail