First American Trust
WEALTH MANAGEMENT SERVICES

Winter 2013

QUARTERLY UPDATE

First American Trust provides investment advisory and fiduciary services for individuals, families, non-profits and corporations.

My Two Cents

By Kimberly Bernatz, CFP®, AEP®

Let's Talk!

Over the holidays, many of us spent more time than usual with our kids, parents, grandparents and other family members. For some families this may have been a blessing, while for others it was an ordeal. The outcome often depends upon family communication patterns that have been in place for generations.

It's difficult enough to find a way to have healthy communication around some of life's everyday issues, but it becomes more complex as families struggle over important financial conversations about topics such as retirement planning, providing care for elderly parents, and strategies for inheritance. Yet, sweeping these important conversations under the rug for fear of real or perceived misunderstandings or conflict can cause significant emotional and financial consequences to emerge.

The results of a 2012 Intra-Family Generational Finance Study by Fidelity Investments shows that adult children and their parents struggle to communicate on key financial topics, and if they do discuss finances, the conversations are not detailed enough. Key findings of the study reveal:

- Adult children would like more details from their parents
- Barriers to begin the conversation exist on both sides
- Once started, conversations are well received and beneficial to families

More Details

Some 90 percent of adult children and parents agree that health and eldercare decisions and estate planning are important issues to discuss, but more than 20 percent of adult children felt that discussions lack details. When it comes to talks about retirement readiness, 65 percent of adult children and parents agree it is an important topic, but only 11 percent of adult children believe that conversations have enough details.

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Market Watch

By Jerry Braakman

Economic Outlook

A New Beginning

The fiscal cliff and all the rhetoric and stress delivered to the markets continue to undermine confidence in our political system. Passage of the Taxpayer Relief Act of 2012 on January 1, 2013, marked the first change in our economic policy since the start of the Great Recession. A rise in taxes (relative to those in effect last year) is the first step in a series of anticipated economic "tightening" moves. Raising taxes slows economic growth by reducing disposable incomes. After several years of stimulus (lower rates, open market bond purchases, government spending increases and tax reductions), this is the first action in the opposite direction. How the economy responds to this change will likely determine next steps for the Fed. While tax increases and spending cuts offer steps to get our rampant deficit under control, the Fed will possibly attempt to reduce or eliminate its bond purchases, unwind its $2.7 trillion bond portfolio, and raise interest rates.

Most would agree the economy is not completely back on track, but support of gradual tightening measures by Federal Reserve governors validates signs of improvement. Still others may argue the economy remains weak, and these "premature" actions could jeopardize recovery. We surmise that rapid economic expansion (as experienced during the housing boom) is unlikely to occur, and any indication of strength could be tempered with additional tightening measures.

So, as investors, where does that leave us? As the last three years indicate, the markets can produce good returns in a slow growth environment, evidenced by annualized returns of 15.45 percent delivered by the S&P from 2010 to 2012. Although revenue and GDP growth is subdued, corporate profits at near record levels focus on expense controls and operation efficiencies, which continue to deliver returns. Low capital costs and investor return expectations assist to provide a fair operating environment for corporations. As a controlled economic recovery mood continues, we anticipate stocks should produce favorable returns.

We believe as the recovery spreads, lagging segments may do better than segments that already bounced from lows. Hence, in our client portfolios, we are starting to focus on later stage cyclical sectors that include airlines and affiliated businesses, and automotive suppliers. The financial sector is another area that offers some late stage opportunities. Some companies we hold within that sector, like JP Morgan and Wells Fargo, have recovered, while those more stressed companies, such as Citibank, are poised for a turnaround we expect will likely add some lift to our portfolios.

Apple continues to dominate the technology sector, and we say there's more upside potential for Apple as it continues to roll out new products worldwide. For Apple to maintain its margin advantage in the future, new product innovation is critical. The entire market will follow this story, and if we had to wager on any company's ability to innovate, we think Apple has the odds in its favor.

The bond market poses more serious challenges. With a record bull market induced by economic and Federal Reserve policy, the party is close to its final hurrah. While we believe interest rate increases by the Fed are more than 18 months away, the market may start anticipating a higher rate environment, likely to push up longer term rates. As a result, the yield curve will steepen and hurt longer maturity bonds.

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Economic Outlook

Agency mortgage pools could be most affected when the Fed stops its open market purchases. Look for this story, still too soon to act upon, to develop as the year progresses. We are monitoring how the new tax increases absorb prior to changing our stance. Actions we will likely take to minimize the impact of these events should reduce our mortgage pool allocations and shorten the duration of bonds we hold. Continued economic strength will help both corporate and municipal bond markets, the latter benefiting from higher tax receipts due to both higher tax rates and increasing property values.

Investment Focus *- Year in Review*

Overall, the equity and bond markets had a good year producing positive results. In addition, our investments outperformed the S&P 500 on the equity side and the Barclay's Intermediate Government Credit Index on the fixed income side for the year.

What Worked

- Housing recovery: To benefit from the turn in home prices, we added Lowe's, Pulte and Masco. We bought Pulte in June, and then sold out in December for more than double the entry point.
- Financials: As housing and economic recovery continued, and capital was restored at banks, resumptions of buybacks, dividend increases and the end of loan deterioration helped support values. This best performing sector, led by Visa, was our heaviest overweight.
- Fixed Income: Our overweight to corporate bonds produced great results. As we anticipated, corporate credit spreads continued to shrink based on strong earnings and balance sheets. Avoiding U.S. Treasury issuance, we focused instead on Agency mortgage pools boosted by another round of QE by the Federal Reserve.

> ***"Our investments outperformed the S&P 500 on the equity side and the Barclay's Intermediate Government Credit Index on the fixed income side for the year."***

Not without Struggles

- Information Technology was a tale of two stories: Apple and everyone else. Although Apple was a positive contributor for the year, stock price swings caused debate despite continued mind-boggling operating numbers. We continue to hold and closely monitor Apple as our largest position, and we also hold Google, whose Android operating system is Apple's biggest competitor.
- While we avoided most calamities in the PC business, such as Hewlett Packard, Dell, and Intel, we were not able to avoid the stress on Marvell Technology. As a component maker of communication semiconductors and chipsets, Marvell was hurt by slowing laptop sales. Marvell's chipsets for mobile devices are in the process of ramping up due to migration to 4G platforms by telecom providers running its technology, primarily overseas. Recently, David Einhorn of Greenlight Capital, a major hedge fund player and activist, bought into Marvell. We believe plenty of catalysts remain for the company to recover.

With continued political bargaining forthcoming, we expect continued volatility at times during the year ahead. However, continued progression along the improvement path the economy has been following should override near term swings and provide a positive outlook for the year.

Market swings will make it as important as ever to remain diligent and opportunistic. As shown over this past year, we believe our advice should continue to add value to client portfolios.

— Jerry Braakman is Chief Investment Officer and Treasurer of First American Trust
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Let's Talk! - continued

Barriers to Conversation

While parents and adult children agree on the importance of frank discussions about eldercare, estate planning, and retirement expenses, the study found that 68 percent of parents and 60 percent of adult children feel more comfortable discussing these issues with a third party financial professional than with each other. The primary concern of parents is that their adult children will become too reliant on a potential inheritance, while adult children expressed reluctance to address these issues as they feel it is none of their business.

But, with parents living longer and the increasing financial complexities that face families today, it's important to have these conversations to make informed decisions and take control of finances, rather than reacting to a crisis in the future.

Conversations are Beneficial

The study found that families who took time to have more detailed conversations experienced reduced anxiety and a dramatic increase in peace of mind. In families who participated in more talks about estate planning, the study validated that those parents' peace of mind jumped from 61 to 91 percent, compared to parents who did not participate in detailed conversations with their adult children.

Our Insight

Each family is unique and possesses different goals. Some families focus on preservation of principal with the desire for wealth to last through several generations. Others may place education as a priority. Still others may choose to make periodic lifetime transfers to young adults to "test the waters" and provide them the opportunity to save, invest, give and spend in a responsible manner.

The advice we give our clients is that these are not topics that should be limited to a one-time discussion; rather, the conversation should be open and ongoing. As children age and circumstances change, shared information varies about legacy, goals and objectives, and other values. It's a fluid discussion. Elder care issues should also be part of financial discussions. Too often, desires aren't discussed in enough detail about who will provide elder care, how expenses will be paid, and what end of life decisions should be made.

Open communication with loved ones is essential to wealth transfer planning. Each family needs to determine how much to communicate and with whom. Keep in mind that such open conversations, often enhanced with the assistance of a trusted financial advisor, provide an opportunity to share financial values, and can help minimize future misunderstandings.

Let's Talk! - continued

Equally important, these conversations can provide peace of mind for parents and children alike.

With more than 50 years of experience and insight working with affluent families on this and myriad other wealth planning issues, our team at First American Trust is pleased to serve as a resource to you. Feel free to reach out and give us a call or an email. We'd love to have a detailed conversation with you.

— Kimberly Bernatz is a Certified Financial Planner and Senior Vice President at First American Trust kbernatz@firstam.com

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Events & Happenings

Here are a few highlights that kept us busy during the last quarter of 2012, as we entertained clients and the community through educational and philanthropic events. We look forward to more of the same in 2013.

Presidential Insights

Two separate soirees were held for our clients shortly before Election Day featuring a presentation by Dr. Lynn Vavreck, a research expert from UCLA on how the economy impacts Presidential elections. At our Santa Ana headquarters, the presentation was followed by a lovely evening reception with cocktails and hors d'oeuvres, while in San Diego, our clients enjoyed the presentation during lunch at the Estancia Hotel & Spa. As part of First American's commitment to support nonprofits in our community, Hoag Hospital Foundation was honored at the Santa Ana event while Scripps Health was honored in San Diego.

Old Globe Theatre Sponsorship

As Founder Sponsors of San Diego's Old Globe Theatre, First American Trust sponsored the annual Craig Noel League Members Luncheon on Monday, November 5, drawing more than 80 supporters of the theatre to partake in a festive and celebratory afternoon of special entertainment and food catered by Hyatt Regency La Jolla. The following month, First American Trust Vice President Pat Hodgkin planned an outing to the Old Globe with Casa de Amparo, a shelter for at risk children, a nonprofit that First American supports as a corporate donor. Hodgkin, committee member of Old Globe and Casa de Amparo, accompanied ten foster children from the shelter to a matinee of Dr. Seuss' How the Grinch Stole Christmas, "I love that I can help two of my favorite charities in one combined effort."

Santa Ana Kiwanis Santa Clauses

In December, First American employee volunteers participated with the Santa Ana Kiwanis chapter to help escort some 50 children, nominated by teachers from area underserved schools, to a local Target. The children, armed with hundred dollar gift certificates and volunteer partner shoppers, fulfilled family Christmas wish lists. Carts filled to the brim with gifts included necessities and a little something for each child shopper. Santa hats, hot cocoa and a visit from St. Nick made the event all the more heartwarming.

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Best Places to Work Award

The Orange County Business Journal voted First American a Best Places to Work Company in Orange County (2012), a recognition that took into account results of an employee engagement and satisfaction survey and a thorough review of our company's policies, practices and benefits. This makes working at First American a validation that we work in a positive environment with loyal and talented workmates, such as client-facing staff who average 10 to 12 years on board.

Give Us Feedback!

Share your comments with us anonymously 24 hours a day, 7 days a week.

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