Lessons Learned from Nancy Reagan’s Estate

We lost an icon this year when Nancy Reagan passed. To me, she represented an era of refinement and grace as First Lady. She had her detractors and flaws as do we all, but I was a fan. I was fortunate to have met her and her “Ronnie” once on the White House lawn when they had just returned from Camp David. Their warmth for each other and others was evident in that brief encounter.

It surprised me that media reports placed the value of her estate at $15 million upon her death. I thought it would be more substantial. After all, her husband was the...  

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Market Watch
By Jerry Braakman, Chief Investment Officer

Market Review
After a difficult first two months of the year, domestic equity markets significantly rebounded in March and April managing to return to positive territory. With economic growth continuing to challenge policy makers, markets have been fickle.

International markets rebounded as risk concerns have, at least temporarily, abated. Similarly, crude oil seems to have bottomed from a mid-$20 per barrel price range to a low-$40 per barrel. Much oil price recovery can be attributed to the lack of a Chinese demand freefall (although still decelerating) and renewed expectation that OPEC will start addressing the oil supply imbalance. We’re not convinced that these issues won’t resurface again later this year.

Bond markets have produced positive returns as yields have moved lower from the start of the year. The 10yr Treasury yield moved lower to 1.83 percent at the end of April from the 2.27 percent yield at year end. The Federal Reserve pace of rate hikes seems to have slowed in light of overseas growth concerns and lower than expected domestic inflation. Although we would not be surprised by a further rate hike later this year, the Fed outlook is now more in line with market expectation.

Stock Selection
Equity investors face significant challenges. One of our primary concerns is that earnings growth seems to have stalled since late 2014. Profit margins peaked at 9.67 percent for S&P 500 companies in Q3 2014 and have since dwindled to 8.10 percent. Similarly, earnings peaked in Q3 2014. Compared to last year, Q1 2016 earnings are lower by 7 percent even though last year experienced a significant weather impact. Earnings and earnings growth are primary drivers of appreciating equity markets. Thus, the recent lack of earnings growth has us concerned. Likewise, domestic equity markets have not moved significantly higher since late 2014. We do not think that trend is by coincidence.

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<table>
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<tr>
<th>Index</th>
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<tr>
<td>Dow Industrials</td>
<td>3.34%</td>
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<td>S&amp;P 500</td>
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<td>1.18%</td>
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<tr>
<td>Gold (SPDR Gold Trust)</td>
<td>14.39%</td>
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Source: Bloomberg as of 5/31/2016
The decline in oil prices significantly impacted earnings in the oil and materials sectors, a large source of the earnings slowdown. Bouncing back to $100+ per barrel crude to recover those lost earnings will not be quick. Reducing capital expenditures, improving liquidity and sheer survival occupy energy sector management.

To best position our client portfolios in such a challenging market, our analyst team refocused their efforts to understand the fundamental prospects of our buy list holdings and took special care to assess valuations. As a result, during the first quarter, we trimmed and sold some of our more stretched valuations that performed well last year and redeployed these proceeds into stocks priced more attractively from a growth and price perspective. For example, we trimmed last year’s winners such as Amazon, Delta and Lowe’s while selling Juniper, Boeing and Express Scripts. We purchased McDonald’s, IBM, Johnson & Johnson and Caterpillar, companies with mature business profiles that pay higher dividend yields and are considered value-oriented stocks. As a result of these changes, we believe our client portfolios are better positioned for balance between growth stocks like Facebook and other stable business models we purchased.

“Equities still have the ability to outperform fixed income over time.”

Besides these concerns, equity markets still provide an attractive asset class relative to other asset class options. Part of the support of equity markets is the lack of other alternatives for investors to find return. With an earnings yield of about 6 percent for the S&P 500 constituent companies as a group, equities still have the ability to outperform fixed income over time. Forward earnings expectations are robust with analyst consensus expecting a recovery in earnings growth in the latter half of 2016. As we’ve seen since the Great Recession, growth prospects have underwhelmed. Less favored and better price valuation stocks are less susceptible to earnings misses going forward, contributing to our shift to a more balanced portfolio, and thus we expect a relatively better risk reward profile.

“Forward earnings expectations are robust with analyst consensus expecting a recovery in earnings growth.”

Yield Challenged Fixed Income

Living on the income stream from fixed income investments is increasingly difficult. Both domestic and global growth has been sub-optimal for the last several years. As a result, central bank policy makers have employed several tactics to spur demand, specifically low interest rates. In Japan and Europe much of the government issued debt is now trading at negative yields, meaning an investor will receive less money over the life on the investment than they invest today. Similarly, domestic debt has trended to lower yields impacting income streams from bonds. As better yielding bonds are maturing for our clients, the impact of the lower yield market environment is felt in lower income distributions to trust income beneficiaries and clients.

To mitigate the impact of lower yield curves, we strategically increased our allocation to investment grade corporate bonds several years ago in our taxable strategies. Examples of investment grade corporate bonds are bonds issued by JPMorgan, AT&T, General Electric and Wells Fargo. This has allowed us to capture the credit spread premium (additional rate paid for probability an issuer of debt may default) boosting our client’s income.

Although we increased our allocation to the corporate bond sub-asset class, we purposely reduced or eliminated our allocation to high yield (junk) bonds, master limited partnerships (MLPs) and foreign debt. Our concerns in these areas have been justified as default risks overseas, and in highly levered and smaller energy sector issuers have increased.

These actions help insulate clients and trust income beneficiaries from the impact of current bond market yields yet keeps them prudently invested in high quality fixed income to support their lifestyles. We anticipate a “lower for longer” rate environment to continue to persist, requiring continued diligence in fixed income investing.

~Jerry Braakman, 
Chief Investment Officer 
jbraakman@firstan.com

Source: Bloomberg

STABILITY  SERVICE  SUCCESS
leader of the most powerful nation in the world. Compared to many of today’s government leaders, heads of industry and leading men and women in Hollywood, her estate was quite modest.

As we think about our own plans for retirement there are some interesting lessons we can learn from the Reagans.

Consider the age you wish to retire
The length of your retirement will depend upon when you retire and how long you will live. This serves as the foundation for understanding what resources you will need during your retirement years.

Reagan left the Oval Office at 77, well past the age many people plan to retire. He continued to work giving speeches for a number of years. Ronald and Nancy lived well into their 90s, reflective of the longer life expectancy becoming more and more common.

The fact that Ronald Reagan worked well into his retirement years allowed them to continue to add substantially to their nest egg. That made a significant difference in their net worth which post White House increased from a reported $4 million to $13 million at the time of his death.

Determine needed income and available resources
This is the fun part. Imagine your ideal retirement. What are your dreams? Do you want to travel, purchase a second home, spend time with family or make charitable contributions? As you consider expenses, factor in health care costs and other living expenses.

A general guideline is to plan on spending 80 percent of your current salary during retirement. Assess your financial resources including savings, investment accounts, real estate and business interests.

The Reagans had a government pension benefit that added to their other retirement income streams. For those who don’t enjoy a pension plan benefit, it’s critical to establish and self-fund retirement savings accounts such as IRAs or 401k plans.

Plan for inflation
Inflation will impact your retirement savings and purchasing power. This is perhaps the biggest point that struck me about Nancy Reagan’s estate value; $15 million does not have nearly the purchasing power it did 25 years ago. According to Consumer Price Index, $100 in 1989 (when Reagan left office) has the same buying power as $192 today. Our cost of living has almost doubled.

To account for inflation, a general rule of thumb is to factor in a four percent annual inflation rate for retirement projections. The higher the rate of return earned on investments the less you will need to save. On the other hand, if investments are performing poorly, you will need to save more. Your rate of return will vary depending upon asset allocation, so it’s important to find the right balance between your comfort level for risk and desired return.

Keep in mind too that older Americans are disproportionately impacted by inflation due to differences in spending habits and price increases in certain categories, such as health care and housing.

Nancy Reagan certainly had sufficient resources to live very comfortably until her death, but the question is, will you? A well-crafted financial plan allows you to see the big picture and set short- and long-term goals that in turn help you stay on track to meet future goals.

Ronald Reagan once said, “Life is one grand, sweet song, so start the music.” I say, “Be sure to have a great financial plan in place so you can enjoy the dance!”

–Kimberly Dwan Bernatz, CFP®, Sr. Vice President
kbernaz@firstamtrast.com

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**Q1 Events & Happenings - Recap**

**Collaborating Trust Law**
Neil Schoenblum attended a three-day conference put on by STEP OC Institute, the organization with the motto, *Advising Families Across Generations*, with UCLA School of Law. The 5th Annual Institute on Tax, Estate Planning and the Economy touched base with international trust and asset management, intellectual property assets and new developments in personal wealth taxation, among other topics helpful to clients for financial planning.

**Equity Markets: Eurozone versus U.S.**
The World Affairs Council of Orange County in partnership with the British American Business Council of Orange County hosted a member’s luncheon where Jerry Braakman was the keynote speaker. He shared his expertise on the relevance of global equity markets with respect to currency wars, oil producers and consumers, as well as monetary policy, and how these markets in the Eurozone affect us globally and compare with U.S. markets.

**First American “In the News”**
Be sure to visit our website for all the latest industry news with quotes from our Chief Investment Officer Jerry Braakman and others.

**San Diego Digest**
This April, our San Diego County Wealth Management Advisors hosted a breakfast where attendees received guidance for community property issues.

**Dinner at the Ritz!**
As part of our non-profit contributions, we hosted the Diamond Circle Dinner with AgeWell Senior Services.

**Team FAF Heart & Stroke Walk**

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**Wealth Management Advisors**
- Kimberly Dwan Bernatz, CFP®, AEP®
  Director Wealth Management Advisory Services
  kbernatz@firstam.com
- Orange County
  Nicholas W. Henry
  nnherny@firstam.com
- William G. Lugaro, CFP®
  wlugaro@firstam.com
- Karen Perrone
  kperrone@firstam.com
- Kenneth E. Petersen, Jr., JD
  kpetersen@firstam.com
- San Diego
  Patricia A. Hodgkin
  phodgkin@firstam.com
- Jay Robinson-Duff, CFA
  JRobinson-Duff@firstam.com
- Las Vegas
  Neil Schoenblum, J.D., LL.M
  nschoenblum@firstam.com
- Jonathan Talbot
  jtalbot@firstam.com