

Executive Summary

Challenge to the Trustee

Managing a private (family) trust can be a difficult job. Because trustees manage property beneficially owned by others, they are held to high standards of care, skill and caution in the discharge of their fiduciary responsibilities. Trustees must comply with a maze of requirements and regulations given by the trust instrument, state statutes and federal income tax law. Further, they must document this compliance.

In addition to these administrative, tax, and regulatory concerns, trustees face the challenge of designing, implementing and managing an investment portfolio that provides both appropriate distributions to current income beneficiaries, and growth sufficient to the reasonable expectations of remaindermen.

Fiduciary decisions can have profound effects on a family's wealth. You need help. But where can you find it? There are many product and service providers with a vested interest in influencing your decisions: stockbrokers, trust officers, mutual fund companies, insurance agents, etc. Some may, indeed, already be trusted advisors. But how many are in a position to offer expert, disinterested investment counsel?

Delegating

A fiduciary pondering delegation of trust administration may choose from at least three alternatives:

Fiduciary Delegation Decisions

Self Trusteed	Professionally Trusteed	Professionally Trusteed and Managed
Administrative Tasks Accounting Tasks Tax Law Compliance	Administrative Services No Investment Management	Administrative Services Investment Management

Based on the fiduciary's decision regarding the appropriate structure for trust administration, certain responsibilities are necessarily retained or delegated:

Self Directed	Investment control Discretionary distribution control
Professionally Trusteed	Custodial functions provided Retain investment decision making authority
Professionally Trusteed and Managed	Custodial and investment functions provided Product menus, pooled trusts, pre-approved money managers

The delegation of administrative and investment duties is, itself, a matter of fiduciary discretion, and is therefore subject to the standards of prudence. Avoidance of excessive costs is one of the most important factors to consider. Thus, selection of service providers and investment advisors demands rigorous due diligence. What should you delegate? What are reasonable costs? How do you evaluate the performance of competing vendors?

"Good decisions sometimes have good outcomes. Good decisions may have bad outcomes. However, a good decision making process maximizes the chance of future success."

Robert Clemen
Duke University

Support from Independent, Unbiased Experts

Schultz Collins Lawson Chambers, Inc., an independent consulting and investment advisory firm, acts as co-fiduciary for a broad cross-section of investment decision issues relating to your trust administration. We don't represent any investment or administrative product or service provider. Our advice is objective and unbiased, and intended solely to help you discharge your responsibilities more effectively.

We can help you achieve your asset management goals in the format that is most appropriate for your family's economic objectives and circumstances. Whether you select a bundled service package offered by a professional trust company or money management firm, or retain personal control over most trustee functions, SCLC can provide information vital for future investment success.

For fiduciaries who wish to self direct investment of trust assets, SCLC helps to ensure a prudent decision making process, wherein likely future consequences of investment decisions can be evaluated prior to taking action. For fiduciaries who delegate administrative and investment tasks to a professional trustee, SCLC provides independent evaluation of investment management performance.

Investment Counsel

SCLC acts as investment counsel.¹ Rather than selling a proprietary investment program, our primary objective is to help fiduciaries make informed investment decisions. We are committed to providing fiduciaries with the information and knowledge that make such decisions possible. We employ the quantitative and statistical methodology of decision analysis, which informs modern scientific research in financial economics. In the words of Robert Clemen of the Fuqua School of Business at Duke University:

Instead of providing solutions, decision analysis is perhaps best thought of as simply an information source, providing insight about the situation, uncertainty, objectives, and trade-offs, and.... yielding a recommended course of action.²

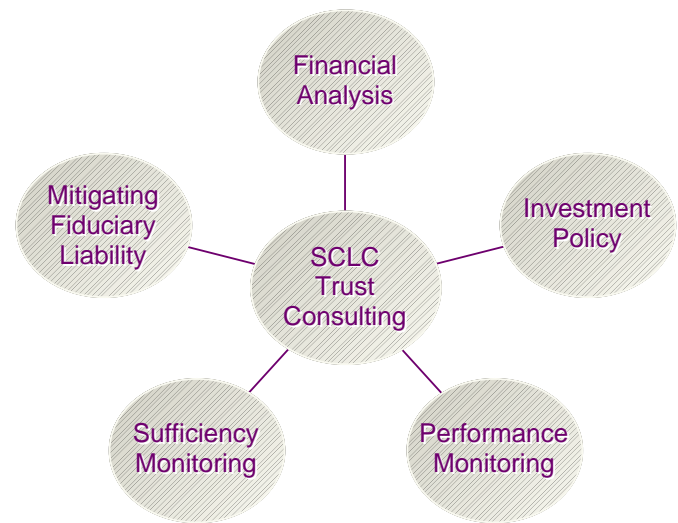
Recognizing that each investor faces a unique set of objectives and circumstances, we provide unbiased and relevant information to help you understand the structure of investment problems and opportunities, the tradeoffs inherent in investment alternatives, and the range of possible future outcomes. We do not force clients into proprietary portfolios. Rather, we help trustees design and supervise their own portfolios, specially structured to fit the unique purposes, terms, distribution requirements, and other circumstances of the trust. We provide information to help you:

- Design a portfolio tailored to the trust's objectives and economic circumstances;
- Improve the chances of realizing a successful outcome for all beneficiaries; and,
- Understand and foresee the risk of possible unsuccessful outcomes.

Making a Difficult Job Easier and Less Costly

Scope of SCLC Trust Consulting

Fiduciaries rely on the specialty expertise of SCLC to help them fulfill responsibilities and mitigate risk. We provide services in a broad range of areas relevant to the trust fiduciary.

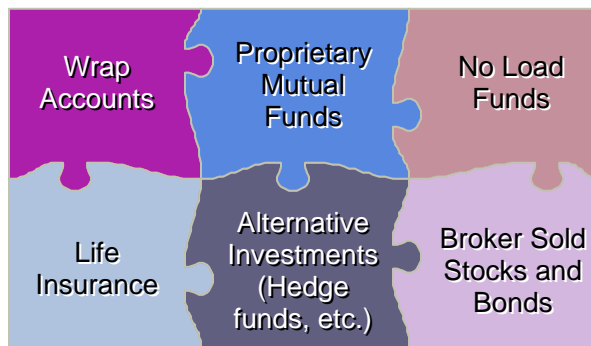


Setting Up the Portfolio

Designing a prudent and suitable portfolio is a complex and challenging task. SCLC can help you:

- Define accumulation and distribution objectives within the constraints of the trust instrument;
- Quantify expected future cash distribution needs;
- Develop investment policy guidelines to meet growth and income targets;
- Model the capital market risk/return tradeoffs inherent in the investment process;
- Assist in the asset allocation decisions required to prudently diversify the trust, thereby mitigating risk; and
- Gain insight into the most important factors for successfully selecting investments.

The Investment Selection Puzzle



"Most trustees receive loads of documentation regarding book-keeping transactions. Most investment decisions are stories about how portfolio managers select stocks. The traditional style of trust department client communication is almost devoid of useful informational content. The traditional services offered by trust departments may be only vaguely related to investment performance."

William F. Sharpe
Stanford University

Monitoring Investment Performance

In order to assure that the portfolio's asset management complies with the trust's investment policy, SCLC provides trustees with a comprehensive investment tracking and review system. At the heart of this system is an accurate return reporting methodology [Time Weighted, Daily Rate of Return] advocated by the Association for Investment Management and Research (AIMR)³. Our investment monitoring services include:

Quarterly Performance Reports	<ul style="list-style-type: none"> Timely updates on portfolio returns Meets AIMR performance presentation standards
Annual Fiduciary Report	<ul style="list-style-type: none"> Review of Investment Policy Comparison with appropriate performance benchmarks Risk adjusted performance measures
Evaluation of Investment Suitability	<ul style="list-style-type: none"> Conformance with selection and retention standards Quantitative analysis of each investment's performance Commentary regarding investment's contribution to portfolio risk/reward objectives Suggested protocol for investment decision making
Useful Accounting Summaries	<ul style="list-style-type: none"> Tax basis reports Portfolio performance over selected time periods Asset allocation investment performance report

Monitoring Dollar Sufficiency

Trust beneficiaries spend dollars, not rates of return. Gauging the likelihood that future cash distribution targets can be supported with the dollars on hand is therefore vital. Even a well-designed portfolio, operating within expected parameters, and approximating its statistically expected return, runs the risk that its actual dollar value at some critical juncture will differ widely from the projected value.⁴ SCLC helps fiduciaries monitor dollar sufficiency by:

- Modeling historical variation in performance;
- Adjusting for year-to-year inflation (CPI) experience;
- Adjusting for contribution/distribution history;
- Determining probability of future dollar surplus or shortfall.

"Future investment returns are an unknown and random variable. The prudent trustee must therefore focus on the integrity of today's decision making process. Mere reliance on past track record in the vague hope that it will repeat in the future is not sufficient to demonstrate care, skill and caution."

Patrick J. Collins
Schultz Collins
Lawson Chambers

Evaluating Professional Trustee and Money Manager Performance

For fiduciaries employing the administrative and investment management services of a professional trustee, SCLC provides objective evaluation of investment performance. Although each such engagement is necessarily unique, they usually encompass two tasks:

- Data organization, review and descriptive statistical analysis;
- Comparative benchmark construction, comparison, and analysis.

We help the fiduciary determine:

- The extent to which the trustee has diversified the portfolio,
- The extent of market risk vs. unique risk within the portfolio,
- The extent to which portfolio performance can be attributed to skill vs. luck,
- The extent to which portfolio performance is a result of market timing vs. security selection,
- The extent to which trustee investment management has added or subtracted value on a risk-adjusted basis.

Controlling Investment Costs

Successful trust asset management must add value after consideration of all fees, commissions, taxes, sales loads, management charges and other transaction costs. A prudently managed portfolio avoids unjustified expenses. Our firm is adamant in its drive to eliminate unwarranted fees and transaction expenses. The following matrix demonstrates the potential negative effects of investment costs on ending dollar values. The matrix assumes a gross annual return of 10%.⁵

Annual Investment Expenses	10 th Year Ending Value	20 th Year Ending Value
1%	-9%	-18%
2%	-18%	-33%

Although it is impossible to implement and manage a “frictionless” portfolio (i.e., to invest without taxes and costs), nevertheless the matrix suggests the importance of the fiduciary duty to avoid unwarranted or inappropriate charges and fees.

Comprehensive evaluation of investment expenses is a complex and daunting task. In your capacity of fiduciary, you must determine if explicit charges and fees are reasonable and appropriate; and, perhaps more importantly, must determine if investment management strategies that promise to “beat the market” provide returns sufficient to compensate for their added risks and costs. Even if such a determination can be made, you must then assess the probable tax results of high-turnover active manager strategies (stock picking and market timing). High costs and heavy taxes may overwhelm whatever benefits are promised by the professional trustee.

Care: Extensive consideration before committing trust assets to a particular course of action.

Skill: Expertise in financial economics and the statistical and quantitative methods underlying Modern Portfolio Theory.

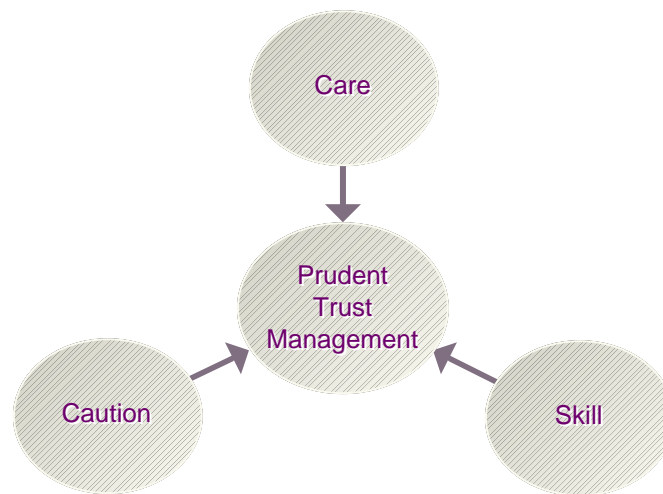
Caution: An unbiased and critical examination of the likely monetary effects of asset management decisions.

Standards under the Prudent Investor Rule

Mitigating Fiduciary Liability Risk

SCLC specializes in helping fiduciaries minimize exposure to litigation risk, using a number of strategies:

- Written Investment Policy—providing assistance in the construction of written policy supporting construction of diversified portfolios that don't rely on short term market forecasting or high-cost trading strategies.
- Procedural Prudence—adopting, documenting and following formal procedures, which define a defensible approach for conducting trust investment business
- Academic Rationale—Consistent with our adherence to the legal standards of prudent investment, the basis of our investment recommendations is grounded in financial economics.



Trust law imposes definite portfolio management standards. Our approach is intended to help fiduciaries demonstrate that they have satisfied these standards by exercising the requisite care, skill and caution in managing the trust's investments.

Summary of Services

In summary, the services we provide to support the investment of trusts include:

- Ensuring the portfolio is designed appropriately for the trust's goals;
- Tracking the performance of the trust's underlying investment vehicles;
- Monitoring progress towards the trust's goals over time; and
- Ensuring that investment costs incurred are reasonable.



Enhancing the Probability of Investment Success

Our goal is to lead our clients to a position of understanding. Decisions can then be made, not on the basis of hunches, or blind trust in another's expertise, but in the context of a rational, comprehensible, legally defensible and academically supported framework. Although our advisory services reflect our understanding of your state's laws regarding trustee duties and responsibilities, we believe that fiduciaries should demand and receive investment advice that conforms to the Prudent Investor Rule.⁶ Consequently, we acknowledge our role as a co-fiduciary for our asset supervision clients, apply requisite principles of prudence, and assume the duties of trust investment counsel.

With our depth of experience and unbiased perspective, we provide trustees with practical, economic and reliable solutions to the broad array of investment management issues encountered by fiduciaries.

Portfolio Management Approach

Determining Client Objectives	<ul style="list-style-type: none">Detailed fact finding to build unique client profileHands on assistance to assess individual financial needs and risk toleranceInvestment goals and approach codified in customized Investment Policy Statement (IPS)
Portfolio Construction	<ul style="list-style-type: none">Asset classes scientifically selected and weighted based on required return and acceptable riskCustomized portfolios designed to meet individual needsBroad global asset class diversificationDiversification within asset class, mitigating systematic riskTurnover managed using passive/indexed strategies
Tax and Expense Management	<ul style="list-style-type: none">No-load investments used to mitigate investment costsInstitutional funds used to minimize fund expense ratiosTax liabilities managed using low turnover strategiesOption to use tax advantaged fixed income (muni bond) funds
Portfolio Monitoring and Surveillance	<ul style="list-style-type: none">Objective criteria for determining ongoing suitability of specific portfolio investmentsComprehensive portfolio performance reportingAnnual review of portfolio results relative to IPS objectives and guidelines
Portfolio Management	<ul style="list-style-type: none">Periodic rebalancing to asset allocation targetsInstitutional trading to reduce transaction expensesAnnual rebalancing activity to avoid impairing portfolio returns in trending markets

About Schultz Collins Lawson Chambers

Our firm brings together a group of highly skilled investment professionals with a diverse range of financial services experience. Our shared belief is that by applying academic developments in the fields of economics, finance and law, we can help our clients develop prudent and suitable investment programs.

Independent, Unbiased Counselors

Schultz Collins Lawson Chambers provides factual and unbiased recommendations for trust owned investments and objective evaluations of existing arrangements. We are not affiliated with any investment product vendor, nor do we seek commissions, finders' fees or similar forms of remuneration. This independence is your assurance that we will put your best interests first.

Helping Build Prudent Portfolios

Our primary objective is to assist trust fiduciaries to construct diversified portfolios, which don't rely on short term market forecasting or high-cost trading strategies. Consistent with our adherence to the legal standards of prudent investment, the basis of our corporate investment philosophy is derived from the body of academic work on financial economics.

Types of Trusts Served

Our partners are experienced working with private (family) trusts, endowments, irrevocable life insurance trusts and qualified retirement plan (ERISA) trusts. We've helped in all areas of trust design, implementation and monitoring. We have worked with trusts of all sizes, from modest "unified credit" (bypass) trusts to trusts with hundreds of millions of dollars in assets.

Co-Fiduciary Role

With our depth of experience and objective perspective, we provide clients with practical, well-priced and reliable solutions to the broad array of issues and problems encountered by trust fiduciaries. As independent advisors, we acknowledge our role as co-fiduciary with respect to the terms, limits and circumstances of our investment advisory agreement for trust services.

End Notes

¹ We are an investment advisor registered with and regulated by the Securities and Exchange Commission, under the Investment Advisors Act of 1940. The Act states that an investment advisor may be designated as “investment counsel” only if a substantial part of its business consists of rendering investment supervisory services [15 U.S.C. § 80b-8(c)]. The Act defines investment supervisory services as “Providing continuing investment advice based on the individual needs of each client.” [15 U.S.C. § 80b-2(a)(13)]

² Clemen, Robert, Making Hard Decisions: An Introduction to Decision Analysis (Duxbury Press, 1996).

³ Recently renamed the “CFA Institute”.

⁴ Collins, P.J., Lawson, K. J., Chambers, J. C., “Monitoring Retirement Portfolio Sufficiency,” Journal of Financial Planning (February, 1997), pp. 66-74.

⁵ Calculated as the difference in terminal value of \$1 continuously compounded at applicable rates of return over the planning horizon.

⁶ *Restatement of the Law, Third, TRUSTS – Prudent Investor Rule*, The American Law Institute, St. Paul, Minn. (1992). *Uniform Prudent Investor Act*, National Conference of Commissioners on Uniform State Laws, Chicago, IL. (October, 1994).