

\* HYD is a hypothetical model based on back-tested results. See p.78 for more information.

## The Joy of (Planned) Giving: More than Meets the Eye

*"We make a living by what we get,  
but we make a life by what we give."*

--- Sir Winston Churchill

Retirees and investors approaching retirement face a low-interest rate environment in which future price inflation is a virtual certainty. The financial industry has responded with a confusing array of products intended to supplement the traditional "spending down" of an investment portfolio. In June we began a series of articles intended to help readers understand the promises and pitfalls of these alternatives. This month we address planned giving, a less well-publicized alternative, which in addition to satisfying one's philanthropic intentions can provide donors with a dependable income stream and attractive tax advantages.

In addition to helping a charity to fulfill its mission, planned giving can garner significant tangible benefits for donors including:

- Federal and state income tax deductions
- Capital gain tax savings on gifts of appreciated assets
- Annual income for life or for a designated term
- Flexibility. Gifts of cash, securities, or other property including buildings and land are possible
- Reduced probate costs and estate taxes
- Expert investment management

In this article we describe three strategies for planned giving: pooled income funds, charitable remainder unitrusts, and charitable lead trusts.<sup>1</sup>

### Pooled Income Funds

A pooled income fund (PIF) is a trust maintained by a sponsoring charity. A PIF operates very much like a mutual fund. The donor contributes property to the trust and is assigned a number of units, depending on the value of the assets donated. These assets are pooled with those of other donors. Typically the donated assets are sold, and the proceeds reinvested in income-oriented securities. Notably, neither the trust nor the donor will incur taxable long-term gains on such sales, so the full market value of the donor's contribution is put to work generating income.

Income generated by the fund (dividends, interest, etc.) is distributed (often quarterly) to the income beneficiaries according to the number of units assigned. The income paid out therefore varies with the level of income generated within the fund. When the last income beneficiary named by the donor dies, the remaining value of the units is distributed to the charity for its charitable purposes.

(Continued next page)

The *Investment Guide* is intended to provide useful information to investors who manage their own financial assets. We also provide low cost discretionary asset management services for individuals and institutions seeking professional advice and assistance in implementing an investment strategy.

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Donors can transfer cash, securities, or other property to a pooled income fund, and receive an income tax deduction at the time of the donation that is based on the estimated present value of the assets that will eventually pass to the charity.

**Example:** Consider a 65 year old investor with charitable intentions, but who is in need of income. She holds GE stock with a market value of \$10,000 and a cost basis of \$1,000. She also wants to diversify her position to reduce her risk exposure. If she donates the stock to a PIF at her favorite charity, the contribution would generate an immediate income tax deduction of \$5,858 for 2012. The charity would immediately sell the GE stock, assign units in the PIF to the donor based on her \$10,000 donation, and reinvest 100 percent of the proceeds in hundreds of income oriented stocks and bonds. Future investment income from those securities will be distributed proportionally to the donor through quarterly payments. Had the donor instead simply sold her stock and reinvested it herself in a taxable account, she would not only miss out on the deduction, she would also incur a realized federal long term capital gain tax of \$1,350 (and possibly a state tax), leaving only \$8,650 for reinvestment.

### Charitable Remainder Unitrusts

A charitable remainder unitrust (CRUT) is another planned giving alternative. CRUTs are similar to PIFs in several respects. They can be established with donations of cash, securities, or other property, and the donor receives an income tax deduction based on the present value of the assets that eventually pass to the charity. The donor pays no capital gains tax on the appreciated value of his property, so the full market value of the property is available for reinvestment within the CRUT. Donors may add funds to their CRUT at any time. When the CRUT term ends, the principal passes to the charity for its

charitable programs.

A CRUT, however, is fundamentally different from a PIF. It is not a pooled account but a separate trust with parameters that can be specified to address intentions and circumstances specific to the donor. Most notably, CRUT donors stipulate the annual fixed percentage of the fund's value (not less than five percent) that must be distributed to income beneficiaries. Payments are made from trust income (dividends and interest), or from trust principal if trust income falls short of the required payout.<sup>2</sup> Income may continue for the lifetimes of the beneficiaries named, a fixed term or a combination of the two.

CRUTs are subject to restrictions. A CRUT will be disqualified if the remainder interest for each contribution is not at least ten percent of the net fair market value of the initial contribution. The only restriction on the naming of beneficiaries is that they must be living at the time the gift is made.

**Example:** Suppose a 60 year old investor has property valued at \$150,000 with a \$40,000 cost basis. The investor is in need of income, but is hesitant to sell the property because he would incur high long-term capital gain taxes (\$16,500). After considering his eventual social security income, pension and his other financial assets, he realizes he will need another \$7,500 per year in order to maintain his current lifestyle. He decides to donate the property to a charity through a CRUT with a five percent payout, naming himself as the income beneficiary for the remainder of his life. He will receive an immediate income tax deduction of \$56,852, and his quarterly payouts for the remainder of 2012 will be \$1,875<sup>3</sup> (or \$7,500 on a full-year basis). Thereafter, each year's quarterly payment level would be based on the CRUT's market value on December 31 of the previous year (for example, if the CRUT were valued at \$147,200 on December 31, 2012, the donor/beneficiary would receive four quarterly payments of \$1,840 during 2013).

### Charitable Lead Trust

A Charitable Lead Trust (CLT) can be used to transfer assets to children or others at a significantly reduced tax liability. Though they can be a powerful tool in gift and estate tax planning, CLTs are complex arrangements that require careful consideration.

In some ways a CLT is the inverse of a CRUT, because a CLT distributes periodic income to the charity, while the remainder at the end of the trust term is either returned to the donor or passed on to heirs. Donors get an income tax deduction if they receive the remainder at the end of the trust term. If the assets are passed on to heirs, applicable estate or gift taxes on the value of the gift are reduced or completely eliminated.

A charitable lead trust may provide either a fixed "annuity" payment or a variable "unitrust" payment to the charity for a specified term, measured either by someone's life or a selected number of years. Low interest rates currently make the annuity payment option attractive for donors as more assets may be passed on to heirs with reduced or eliminated transfer tax liability.

The tax benefits of a charitable lead trust depend on several factors, including the value of the donated asset, the duration of the trust, the type of trust (grantor or non-grantor; annuity trust or unitrust), the charitable payout rate and the Federal Reserve Board discount rate.

**Example:** A donor places \$1,000,000 in a twenty-year charitable lead trust to benefit her favorite charity. The trust agreement stipulates that the charity is to receive \$40,000 in income tax annually. At the end of the twenty-year term, the donor's daughter is to receive the principal. Only the estimated present value of the projected remainder that will pass to the daughter is subject to taxation. In this case the estimated present value of the eventual remainder is \$115,000 so in 20 years the donor's estate will distribute any remainder value in excess of \$115,000 to the donor's daughter, undiminished by the estate tax.

1 Investors may also wish to consider charitable gift annuities, which are not covered in this article. For more information, see <https://www.aier.org/article/46-charitable-gift-annuities>

2 The donor may also stipulate that distributions are to be up to "income only," with or without a further stipulation that any shortfall of actual income received by the funds from the fixed percentage be "carried forward," and be available for distribution in subsequent years in which the actual income is in excess of the fixed percentage.

3 The first quarterly payment would be prorated if his donation is made before quarter-end.

## QUARTERLY REVIEW OF CAPITAL MARKETS<sup>1</sup>

Stocks, bonds and gold all provided strong returns during the third quarter. Global equity markets reversed course, bringing year-to-date returns solidly into positive territory. Foreign stocks were bolstered by renewed cooperation among European states, which calmed fears regarding the future of the euro. In the U.S. the Fed formally announced a new round of quantitative easing and stated its willingness to keep rates low through mid-2015. In short, global markets appear optimistic that easy money policies in the U.S., Japan, and the European Union will bolster

growth, or at least prevent a relapse into recession.

A backdrop of gloomy news persists, however. The economic recovery remains anemic, federal deficits show no sign of abating, the fiscal outlook in several states is dim, and potential tax hikes loom. Overseas, European and Chinese economies are faltering and the Middle East is in crisis.

As the year comes to a close investors are likely be assailed with good news and bad; the only certainty is that the modern media will amplify and distort the impact of these developments.

The dilemma for investors was well-summarized by the Wall Street Journal's Jason Zweig: "It's harder than ever for long-term investors to ignore the trading madness of Mr. Market. But ignoring it remains the very essence of what it means to be an investor."

We have made no changes to our recommended allocations, which can be found in the accompanying AIS Model Portfolios table.

### Cash and Equivalent Assets<sup>2</sup>

In September the Fed announced

### AIS Model Portfolios<sup>1</sup> For the Period Ending September 30, 2012

Asset Class	Index	Recommended Percentage Allocations <sup>2</sup>			Asset Class Statistics: Risk and Return (%)			
		Conservative	Moderate	Aggressive	1 Year	10 Year	20 year	20 year Std. Dev. (annualized)
Cash & Equivalent Assets <sup>3</sup>	3 Month CD Index	20	10	0	0.35	2.17	3.49	0.65
Short/Int. Fixed Income	Barclays Capital 1-5 Yr Govt/Cred	40	30	0	2.47	3.84	5.14	2.24
Real Estate	DJ US Select REITs Index	10	10	10	32.06	11.28	11.05	20.98
U.S. Large Cap Growth	Russell 1000 Growth Index (USD)	5	5	10	29.19	8.41	7.55	17.42
U.S. Large Cap Value	Russell 1000 Value Index (USD)	15	20	30	30.92	8.17	9.31	15.00
U.S. Small Cap Value	Russell 2000 Value Index (USD)	5	7	13	32.63	9.68	10.69	17.42
	DFA US Micro Cap Portfolio (USD)	0	3	7	33.32	10.82	11.71	21.06
Foreign Developed Markets	MSCI EAFE Index (USD) Gross Div	5	7	13	14.33	8.69	5.94	17.05
Foreign Emerging Markets	MSCI Emg. Mkts. Index (USD) Gross Div	0	3	7	17.33	17.37	8.91	24.11
Gold Related	Gold (London PM Fix Price)	0	5	10	9.63	18.57	8.48	16.01
	Total	100	100	100				

#### Model Portfolio Statistics<sup>4</sup>: Risk, Return (%) and Growth

	Conservative	Moderate	Aggressive
Portfolio Return 1 Year	10.80	14.81	24.81
Portfolio Return 10 Year (annualized)	6.23	8.21	10.44
Portfolio Return 20 Year (annualized)	6.71	7.85	9.25
Portfolio Standard Deviation 20 Year (annualized)	5.93	8.31	13.96
Growth of \$100 over 20 Years	\$366	\$453	\$587

1 Past performance may not be indicative of future results. Therefore, no current or prospective investor should assume that the future performance of any specific investment, investment strategy (including the investments and/or investment strategies recommended by the AIS), or product made reference to directly or indirectly, will be profitable or equal to past performance levels. Historical performance results for individual investment indexes and/or categories, generally do not reflect the deduction of transaction and/or custodial charges or the deduction of an investment-management fee, the incurrence of which would have the effect of decreasing historical performance results. The results portrayed in this portfolio reflect the reinvestment of dividends and capital gains. Model Portfolio Statistics are hypothetical and do not reflect historical recommendations of AIS. Annual portfolio rebalancing is assumed.

2 For our recommended investment vehicles for each asset class, see page 80.

3 Investors should maintain cash balances adequate to cover living expenses for up to 6 months in addition to the cash levels indicated.

4 AIS Model Portfolio returns reflect the deduction of 0.68% management fee, the annual rate assessed to a \$500,000 account managed through our Professional Asset Management service.

### Total Return (%)

	2009				2010				2011				2012				Entire Period 4Q 2009- 3Q 2012
	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q				
Barclay Capital 1-5 Yr. Govt./Credit	0.42	1.20	1.78	1.66	-0.60	0.27	1.49	0.91	0.43	0.54	0.59	0.89	9.53				
Vanguard REIT Index	9.05	10.02	-4.01	13.10	7.42	6.50	3.51	-14.59	15.20	10.71	3.70	-0.07	59.65				
Vanguard Value Index	4.41	6.16	-10.93	9.71	10.17	<b>7.02</b>	-0.64	-15.53	12.44	10.58	-2.46	5.74	31.64				
High-Yield Dow 4/18	8.13	1.81	-8.97	<b>20.83</b>	6.69	6.66	2.05	-7.58	<b>17.17</b>	2.48	<b>11.29</b>	7.05	<b>71.93</b>				
Vanguard Small Cap Value Index	3.79	<b>10.15</b>	-10.15	10.68	<b>13.95</b>	6.88	-1.87	-20.67	15.18	12.08	-3.15	5.45	36.94				
Vanguard Growth Index	7.88	4.85	-12.16	13.37	12.02	4.95	0.91	-13.40	10.90	<b>15.22</b>	-3.92	6.78	40.62				
Vanguard Developed Markets Index	1.67	1.26	-14.61	17.60	6.74	3.08	2.12	-20.11	4.01	11.54	-6.86	6.35	4.89				
Vanguard Emerging Markets Index	8.26	2.47	-9.12	18.74	7.49	1.78	-0.97	-23.97	5.99	13.94	-8.41	6.45	7.24				
Gold (London PM Fix)	<b>9.21</b>	2.57	<b>11.52</b>	5.06	7.54	2.38	<b>4.62</b>	<b>7.61</b>	-5.49	8.59	-3.85	<b>11.10</b>	63.31				

plans to buy as much as \$85 billion of mortgage-backed securities per month through year-end in order to keep interest rates low and expressed willingness to keep rates low through mid-2015. The fed funds rate remained at 0.25 percent during the quarter.

Rates on cash and equivalent assets hardly changed during the quarter. One-year Treasury yields remained essentially unchanged, closing the quarter at 0.17 percent yield while three-month Treasury bills were paying 0.10 percent.

Year-over-year price inflation measured 1.97 percent through September, measured by the CPI. Over the same period AIER's Everyday Price Index (EPI) increased 13.0 percent, and rose by 1.0 percent during September alone (or 13.2 percent on a compound annual basis). The EPI measures prices only for goods and services that consumers purchase on a day-to-day basis such as groceries and gas, and is not seasonally adjusted. The EPI is extremely volatile so to extrapolate from one month is not especially meaningful. However, September's increase follows a 1.8 percent increase in August.

The Social Security Administration announced that seniors will see their social security income rise by 1.7 percent beginning in January, a result of the 2013 cost-of-living adjustment (COLA). This COLA is based on the CPI-W and, as AIER has pointed out, falls well short of the year-to-date change in EPI of 5.2 percent.

### Fixed Income

The yield curve hardly changed during the third quarter, though rates have generally fallen over the past 12 months (see yield curve chart nearby).

The relative safety of sovereign debt remained popular among investors across the globe. Nominal yields

on government obligations remained at or near historic lows throughout the quarter and in some cases turned negative. In the U.S. real yields (yields adjusted for current price inflation) are negative for all maturities up to 20 years. U.S.

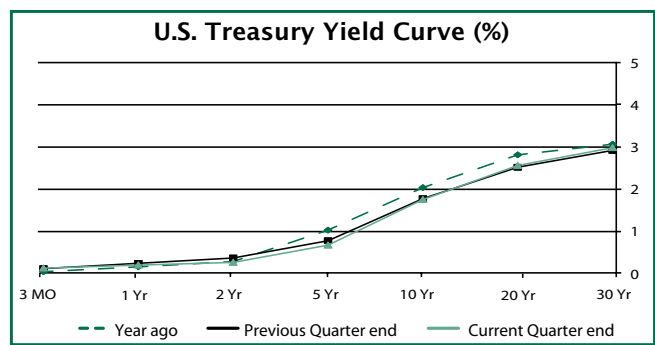
Treasuries as a whole returned 0.6 percent during the third quarter while inflation-protected U.S. Treasuries (TIPS) returned 2.1 percent.

Credit risk was rewarded during the three months, as U.S. corporate yield spreads relative to Treasuries narrowed by 0.43 percent, driven largely by rising prices in the lower-credit segment of the corporate bond universe. For the three months, investment-grade credit provided a 2.9 percent return.

Municipal bonds were up 2.3 percent for the quarter. State revenues have improved steadily since the year began, and local tax revenues are increasing. This bodes well for munis in general. We continue to recommend a broadly diversified, high-quality muni bond portfolio especially for investors in higher tax brackets. The current yield to maturity on the 10-year U.S. Treasury is 1.74 percent, while AAA muni bonds were yielding 1.82 percent on a pre-tax basis. For investors in the highest federal income tax bracket (35 percent) this translates to an after-tax muni yield of 2.8 percent. This yield increases to 3.0 percent assuming currently legislated tax changes go into effect in 2013.

### Real Estate<sup>3</sup>

Real Estate Investment Trusts (equity REITs) lagged other asset classes during the quarter, posting a gain of



1.03 percent. REITs ended the quarter with an indicated dividend yield of 3.4 percent. For the year-to-date, REITs have rewarded investors with a 16.1 percent total return. Returns can vary widely among REIT subsectors. Year-to-date (through September) total returns have ranged from 5.17 percent (apartments) to 29.7 percent (Timber).

Equity REIT returns are not strongly correlated with the returns of bonds or stocks, and have historically provided returns well in excess of price inflation. REITs are lightly liquid and provide a strong level of dividend income because by law REITs are required to pay out at least 90 percent of taxable income to their shareholders in the form of dividends. Because this income is taxable as ordinary income, investors should hold REITs in tax-deferred accounts if possible.

### U.S. Equities<sup>4</sup>

The broad U.S. equity markets posted a 6.2 percent total return for the quarter. Large cap value stocks led with a return of 6.5 percent, but returns were strong across the size and style risk spectrum. Large cap growth stocks returned 6.1 percent while small cap value shares ended the quarter with a 5.7 percent return.

Among industries, energy stocks performed the strongest, rising 10.1

1 This article contains information provided by The Vanguard Group, Fidelity Investments and Dimensional Fund Advisors as well as data obtained from several index providers.

2 Sources for cash and equivalent and fixed income statistics: U.S. Treasury, U.S. Labor Department (Bureau of Labor Statistics), Fidelity Management and Research Company, Dimensional Fund Advisors. U.S. Treasuries: Barclays Capital (BC) U.S. Treasury Index. Intermediate Corporate (investment grade) bonds: BC Intern Credit Bond Index; Municipal bonds: BC Municipal Bond Index; TIPS: BC U.S. TIPS Index.

3 REIT data provided by National Association of Real Estate Trusts (NAREIT). (FTSE NAREIT All Equity REIT Index).

4 U.S. Market: Russell 3000 Index. Small cap value stocks: Russell 2000 Value Index, Large caps: Russell 1000 Growth & Russell 1000 Value Indices. Sector returns represented by S&P 500 sectors.

5 Source: Dimensional Fund Advisors and Fidelity Management and Research Company: Developed markets Large Cap-- MSCI World ex-USA Index, Small Cap -- MSCI World ex USA Small Cap Index. Value -- MSCI World ex USA Value Index Growth -- MSCI World ex USA Growth. Emerging markets: MSCI Emerging Markets Index, Small Cap MSCI Emerging Market Small Cap Index. Non-U.S. developed market stocks MSCI World ex USA. Country performance provided by Dimensional Fund Advisors, based on respective indexes in the MSCI All Country World ex USA IMI Index (for developed markets) and MSCI Emerging Markets IMI Index. All returns in US currency and net of withholding tax on dividends. MSCI data copyright MSCI 2012, all rights reserved. Currency data: Dimensional Fund Advisors, Oanda.com.

6 All gold prices and returns based on London PM fix.

percent, as oil prices increased. Unlike the previous quarter, when traditionally defensive sectors turned in the highest returns, it was the more economically sensitive sectors that performed best over the three months ending in September.

Our high-yield Dow model outperformed our benchmark indices during the quarter, and its hypothetical returns have generally outperformed other large cap value benchmarks over the past year (see chart and table on page 78). We suspect investors may be attracted to dividend paying stocks amidst paltry yields offered by U.S. treasuries and corporate bonds. The model added two tech stocks over the past two months. In September Intel replaced Pfizer as the fourth-highest yielding stock in the DJIA, and in October Hewlett Packard claimed the fourth spot.

### International Equities<sup>5</sup>

The third quarter story among developed international markets was similar to that in the U.S., as foreign stocks in aggregate registered strong returns across risk dimensions. Markets reacted positively to news that the European Stability Mechanism had passed muster with Germany's constitutional court, alleviating fears regarding the viability of the euro. Small stocks outperformed large stocks with returns of 8.6 percent and 7.3 percent, respectively. Value stocks returned 7.8 percent versus 6.8 percent for growth stocks. Among developed market countries Greece was the big winner, with a total return of 21 percent. Only Japan registered a loss, with a -0.63 percent return

Emerging markets nearly regained what they had lost during the previous three months, returning 7.9 percent. Small caps returned 8.4 percent versus 7.7 percent for large caps, while returns on growth shares rose 8.3 percent versus

### Gold Related Assets<sup>6</sup>

The gold price began the quarter at \$1,599 per ounce and remained within a range of \$1,556 and \$1,623 until late August, when it began to rise, and closed the three months at \$1,776.

The price rise resulted largely in response to further central bank measures intended to stimulate growth. In late July and August, as fears emerged regarding Spain's sovereign debt, the European Central Bank (ECB) signaled it was prepared to support the euro and intervene aggressively in bond markets if necessary. The ECB restated its aggressive bond buying stance in early September. At the end of August Fed chairman Ben Bernanke signaled an easy-money policy would continue. On September 13 the Fed formally announced further quantitative easing (QE 3), and stated the Fed was willing to target zero percent short term interest rates through mid-2015. The Bank of Japan (BoJ) announced a

doubling of its asset purchase program in mid-September. As global growth slowed, markets appeared to anticipate further monetary stimulus on the part of central banks in India, China, Brazil and South Korea.

We continue to recommend that most investors hold gold in limited proportion, as specified in the AIS Model Portfolios table nearby. Gold should be held as a cornerstone of most portfolios, primarily as a defense against monetary uncertainty and, as we pointed out last month, as a form of insurance against unanticipated global crises.

## Planned Giving and AIER

We encourage readers who have philanthropic intentions to contact their favorite religious institution, alma mater or other charitable institution to inquire regarding possible donations to a planned giving program.<sup>1</sup>

Our parent organization, the American Institute for Economic Research (AIER) is an educational entity, organized as a public charity under section 501(c)(3) of the federal income tax code. AIER's planned giving programs, established in 1969, have benefited donors and supported AIER's mission through booms, busts, inflation and global turmoil. These accounts are managed by AIS; we employ the principles espoused regularly in the *Investment Guide*.<sup>2</sup>

Just as our investment approach takes a long-term view of capital markets, AIER's planned giving programs offer tax-advantaged lifetime income plans for as many as three generations of income beneficiaries, providing the possibility of future income for you, your children and even your grandchildren. Few organizations are willing to commit to a program that often will not generate proceeds for the charity's use for several decades. AIER views these programs not only as a source of support for its educational programs, it is also reflects a long-term commitment to helping individuals protect their financial future.

For more information, call the planned giving office at 413-528-1216 ext 3153 or email pgo@aier.org. Potential donors can also run financial simulations at [www.aier.org](http://www.aier.org).

All investors should consult with their tax advisor or attorney before donating through a planned giving program.

<sup>1</sup> AIS can help charities establish planned giving programs. Call 413 528 1216 for more information.  
<sup>2</sup> For a detailed review of our approach to managing AIER's charitable trust funds, see the March and April 2012 issues of *Investment Guide*.

7.2 percent for value shares. Among individual countries Egypt and India provided the strongest results, rising 25.4 percent and 15.2 percent respectively.

Returns in both developed and emerging markets were bolstered by a weaker dollar. Among non-U.S. developed market, returns registered 7.3 percent in dollars but only 4.9 percent in local currencies. In emerging markets returns were 31 percent higher in dollars versus returns in local currencies.

U.S. investors should continue to maintain exposure to foreign equities, consistent with our recommended allocations (see accompanying AIS Model Portfolios table).

## GIFTS AND ESTATE TAXES: CHANGES AFOOT

Many investors are unaware that gift and estate taxes can significantly reduce assets intended to be left to their heirs. Taxable estates include all property left to heirs, including bank accounts, retirement plans, taxable gifts made during one's lifetime, life insurance proceeds, IRAs, and home equity.

The simplest way to reduce estate taxes is to give assets away. In addition to reducing your eventual estate tax burden, gifts to intended heirs during your lifetime enable you to see the benefits of those gifts while you are still living.

The federal tax code allows individuals to give as much as \$13,000 tax free to a particular beneficiary free of federal gift taxes during 2012; in 2013 this "annual exclusion" is slated to rise to \$14,000. A husband and wife can give twice as much (\$26,000 for 2012) without triggering the gift tax. This year a married couple with three children and six grandchildren can therefore make tax-free gifts of up to \$234,000 to their children and grandchildren. If they give the maximum exclusion to each

individual again in 2013, they will have reduced their taxable estate by \$486,000 in just two years.

In short, annual exclusion gifts produce estate tax savings limited only by the number of heirs, life expectancy, and, of course, the assets at your disposal.

The federal tax code also provides a unified gift and estate tax credit which, in 2012, effectively allows as much as \$5.12 million of an estate (\$10.24 million for couples) to pass to heirs free of the estate tax. Amounts in excess of the exemption are taxed at 35 percent. *In the absence of new legislation, the exemption is slated to return to \$1 million (\$2 million for couples) on January 1, 2013 and the top estate tax rate will return to 55 percent. So if you are thinking about gifting to heirs, see your estate planning attorney promptly.*

A bypass trust, also called a credit shelter trust, is the best way to preserve the full \$5.12 million exemption for each spouse and thereby shelter as much as \$10.24 million for heirs. Typically, when the first spouse dies, these trusts are fully funded with assets valued at the credit

equivalent, thereby shielding \$5.12 million (currently) in that estate. Those assets, if the trust is properly structured, ultimately escape estate taxation on the death of the second spouse as well. The income left in such trusts is usually payable to the surviving spouse or other family members, with access to principal available as directed by the trust document.

If funds are ample and estates appear subject to the estate tax levy, it could be advisable to make taxable gifts, i.e. gifts over and above the annual exclusion. In such instances, the income from the property and its future appreciation could eventually add to the taxable estate. Giving the property away today at today's values and filing a gift tax return (no tax will actually have to be paid until the total value of such taxable gifts in your lifetime exceeds the \$5.12 million exemption) could therefore serve to reduce total taxes paid. To the extent that the unified credit is used for current gifts, it is not available later to offset estate taxes.

### THE HIGH-YIELD DOW INVESTMENT STRATEGY

#### Recommended HYD Portfolio

As of October 15, 2012

	Rank	Yield (%)	Price (\$)	Status	—Percent of Portfolio—	
					Value (%)	No. Shares (%) <sup>1</sup>
AT&T	1	5.00	35.21	Holding**	23.84	23.53
Verizon	2	4.63	44.50	Holding**	24.30	18.98
Intel	3	4.14	21.73	Buying	2.89	4.63
Hewlett-Packard	4	3.65	14.47	Buying	1.52	3.64
Merck	5	3.61	46.59	Selling	24.89	18.57
Pfizer	8	3.44	25.57	Selling	22.54	30.65
Cash (6-mo. T-Bill)	N/A	N/A	N/A		0.03	--
Totals					100.00	100.00

\*\*Currently indicated purchases approximately equal to indicated purchases 18 months ago. <sup>1</sup> Because the percentage of each issue in the portfolio by value reflects the prices shown in the table, we are also showing the number of shares of each stock as a percentage of the total number of shares in the entire portfolio.

Subscribers can find a full description of the strategy and methodology in the "Subscribers Only" (Log in required) section of our website: [www.americaninvestment.com](http://www.americaninvestment.com).

The total returns presented in the table below represent changes in the value of a hypothetical HYD portfolio with a beginning date of January 1979 (the longest period for which data was available for the HYD model and relevant indexes) through September 30, 2012\*.

	<u>1 mo.</u>	<u>1 yr.</u>	<u>5 yrs.</u>	<u>10 yrs.</u>	<u>20 yrs.</u>	<u>Since 1/79</u>	<u>Std. Dev.</u>
HYD Strategy	4.04	42.49	3.14	11.58	11.90	15.70	17.86
Russell 1000 Value Index	3.17	30.92	-0.90	8.17	9.31	12.01	15.00
S&P 500 Index	2.58	30.20	1.05	8.01	8.50	11.51	15.46
Dow	2.75	26.52	2.16	8.60	9.83	N/A	15.42

\*Data assume all purchases and sales at mid-month prices (+/-\$.125 per share commissions), reinvestment of all dividends and interest, and no taxes. The 5-, 10- and 20-year total returns are annualized, as is the standard deviation of those returns since January 1979, where available. Model HYD calculations are based on hypothetical trades following a very exacting stock-selection strategy. They do not reflect returns on actual investments or previous recommendations of AIS. Past performance may differ from future results. Historical performance results for the Russell 1000 Value Index and the Dow Jones Industrial Index do not reflect the deduction of transaction and/or custodial charges, or the deduction of an investment-management fee, the incurrence of which would have the effect of decreasing historical performance results. HYD Strategy results reflect the deduction of 0.55% management fee, the annual rate assessed to a \$500,000 account managed through our High Yield Dow investment service.

## RECENT MARKET STATISTICS

## Precious Metals &amp; Commodity Prices (\$)

	10/15/12	Mo. Earlier	Yr. Earlier
Gold, London p.m. fixing	1,736.00	1,775.50	1,678.00
Silver, London Spot Price	33.22	34.71	31.82
Copper, COMEX Spot Price	3.71	3.85	3.41
Crude Oil, W. Texas Int. Spot	91.84	98.99	86.79
Dow Jones Spot Index	454.71	468.94	441.79
Dow Jones-UBS Commodity Index	145.38	152.01	148.21
Reuters-Jefferies CRB Index	304.55	320.93	317.18

## Interest Rates (%)

U.S. Treasury bills - 91 day	0.11	0.11	0.02
182 day	0.15	0.13	0.06
52 week	0.18	0.17	0.10
U.S. Treasury bonds - 10 year	1.70	1.88	2.26
Corporates:			
High Quality - 10+ year	3.41	3.67	4.13
Medium Quality - 10+ year	4.53	5.03	5.52
Federal Reserve Discount Rate	0.75	0.75	0.75
New York Prime Rate	3.25	3.25	3.25
Euro Rates			
3 month	0.21	0.26	1.57
Government bonds - 10 year	1.47	1.62	2.05
Swiss Rates - 3 month	0.04	0.05	0.04
Government bonds - 10 year	0.58	0.67	1.00

## Exchange Rates (\$)

British Pound	1.606900	1.624400	1.580800
Canadian Dollar	1.022000	1.029900	0.985420
Euro	1.295000	1.314200	1.386100
Japanese Yen	0.012700	0.012800	0.012930
South African Rand	0.113500	0.121700	0.127800
Swiss Franc	1.072000	1.081100	1.119320

## Securities Markets

	10/15/12	Mo. Earlier	Yr. Earlier
S & P 500 Stock Composite	1,440.13	1,465.77	1,224.58
Dow Jones Industrial Average	13,424.23	13,593.37	11,644.49
Dow Jones Bond Average	323.06	314.91	281.60
Nasdaq Composite	3,044.11	3,183.95	2,667.85
Financial Times Gold Mines Index	3,159.72	3,330.73	3,723.63
FT EMEA (African) Gold Mines	2,865.26	2,972.59	3,234.85
FT Asia Pacific Gold Mines	12,999.59	13,768.77	16,770.46
FT Americas Gold Mines	2,741.07	2,898.91	3,218.12

## Coin Prices (\$)

	10/15/12	Mo. Earlier	Yr. Earlier	Prem (%)
American Eagle (1.00)	1,799.80	1,780.90	1,702.68	3.68
Austrian 100-Corona (0.9803)	1,693.22	1,680.72	1,603.13	-0.50
British Sovereign (0.2354)	420.40	417.40	401.50	2.87
Canadian Maple Leaf (1.00)	1,769.90	1,757.00	1,681.20	1.95
Mexican 50-Peso (1.2057)	2,086.30	2,070.90	1,975.30	-0.32
Mexican Ounce (1.00)	1,751.00	1,738.20	1,658.80	0.86
S. African Krugerrand (1.00)	1,769.18	1,754.38	1,679.18	1.91
U.S. Double Eagle-\$20 (0.9675)				
St. Gaudens (MS-60)	1,825.00	1,790.00	1,695.00	8.66
Liberty (Type I-AU50)	2,012.50	2,025.00	1,982.50	19.82
Liberty (Type II-AU50)	1,910.00	1,790.00	1,870.00	13.72
Liberty (Type III-AU50)	1,810.00	1,775.00	1,680.00	7.77
U.S. Silver Coins (\$1,000 face value, circulated)				
90% Silver Circ. (715 oz.)	23,350.00	23,750.00	22,737.50	-1.69
40% Silver Circ. (292 oz.)	9,550.00	9,725.00	9,037.50	-1.55
Silver Dollars Circ.	28,500.00	27,250.00	25,075.00	10.90

Note: Premium reflects percentage difference between coin price and value of metal in a coin, with gold at \$1,736.00 per ounce and silver at \$33.22 per ounce. The weight in troy ounces of the precious metal in coins is indicated in parentheses.

## THE DOW JONES INDUSTRIALS RANKED BY YIELD\*

Ticker Symbol	Market Prices (\$)			12-Month (\$)		Amount (\$)	Latest Dividend		Indicated		
	10/15/12	9/14/12	10/15/11	High	Low		Record Date	Payable Date	Annual Dividend (\$)	Yield†	
AT&T	T	35.21	37.26	29.17	38.58 H	27.41	0.440	10/10/12	11/1/12	1.760	5.00
Verizon	VZ	44.50	44.53	37.33	47.32 H	35.32	0.515	10/10/12	11/1/12	2.060	4.63
Intel Corp	INTC	21.73	23.37	23.50	29.27	21.40	0.225	11/07/12	12/1/12	0.900	4.14
Hewlett-Packard	HPQ	14.47	18.17	26.11	30.00	14.02 L	0.132	9/12/12	10/3/12	0.528	3.65
Merck	MRK	46.59	43.62	32.98	46.63 H	32.19	0.420	9/17/12	10/5/12	1.680	3.61
Johnson & Johnson	JNJ	68.60	68.47	64.72	69.75	61.05	0.610	8/28/12	9/11/12	2.440	3.56
Dupont	DD	49.01	52.24	45.09	53.98	43.06	0.430	8/15/12	9/12/12	1.720	3.51
Pfizer	PFE	25.57	23.80	19.04	25.62 H	18.15	0.220	8/03/12	9/5/12	0.880	3.44
McDonald's	MCD	93.50	91.70	89.94	102.22	85.92	0.770	12/03/12	12/17/12	3.080	3.29
Procter and Gamble	PG	68.71	69.16	64.89	69.97 H	59.07	0.562	10/19/12	11/15/12	2.248	3.27
Chevron	CVX	112.82	117.25	100.47	118.53 H	92.29	0.900	8/17/12	9/10/12	3.600	3.19
Microsoft Corp.	MSFT	29.51	31.21	27.27	32.95	24.30	0.230	11/15/12	12/13/12	0.920	3.12
Cisco	CSCO	18.55	19.49	17.55	21.30	14.96	0.140	10/04/12	10/24/12	0.560	3.02
General Electric	GE	22.64	22.11	16.60	23.18 H	14.68	0.170	9/24/12	10/25/12	0.680	3.00
J P Morgan	JPM	42.38	41.57	31.89	46.49	28.28	0.300	10/05/12	10/31/12	1.200	2.83
United Tech.	UTX	76.15	82.45	74.64	87.50	70.41	0.535	11/16/12	12/10/12	2.140	2.81
Coca-Cola	KO	38.13	38.12	67.85	79.36	37.11	0.255	9/14/12	10/1/12	1.020	2.68
Travelers	TRV	69.79	68.58	51.27	70.00 H	49.52	0.460	9/10/12	9/28/12	1.840	2.64
3M Company	MMM	92.79	93.98	78.89	95.46 H	75.49	0.590	8/24/12	9/12/12	2.360	2.54
Caterpillar	CAT	82.81	93.17	84.09	116.95	78.25	0.520	10/22/12	11/20/12	2.080	2.51
Exxon Mobil	XOM	91.51	92.30	78.11	93.36 H	73.90	0.570	8/13/12	9/10/12	2.280	2.49
Boeing	BA	72.25	71.28	63.89	77.83	61.33	0.440	8/17/12	9/7/12	1.760	2.44
Wal-Mart Stores	WMT	77.15	74.50	55.46	77.35 H	54.48	0.398	12/07/12	1/2/13	1.590	2.06
Home Depot, Inc.	HD	60.65	59.46	35.05	63.20 H	34.43	0.290	8/30/12	9/13/12	1.160	1.91
IBM	IBM	208.93	206.81	190.53	211.79 H	176.17	0.850	8/10/12	9/10/12	3.400	1.63
Unitedhealth Group	UNH	57.49	54.25	47.22	60.75	42.86	0.213	9/14/12	9/21/12	0.850	1.48
American Express	AXP	57.59	59.27	46.10	61.42	44.69	0.200	10/05/12	11/9/12	0.800	1.39
Alcoa	AA	8.80	9.84	10.14	11.66	7.97	0.030	11/02/12	11/25/12	0.120	1.36
Walt Disney	DIS	50.79	52.35	34.47	53.40 H	33.13	0.600	12/16/11	1/18/12	0.600	1.18
Bank of America	BAC	9.44	9.55	6.19	10.10	4.92	0.010	9/07/12	9/28/12	0.040	0.42

\* See the Recommended HYD Portfolio table on page 78 for current recommendations. † Based on indicated dividends and market price as of 10/15/12.

Extra dividends are not included in annual yields. H New 52-week high. L New 52-week low. (s) All data adjusted for splits and spin-offs. 12-month data begins 10/16/11.

/ Dividend increased since 9/15/12 D Dividend decreased since 9/15/12

RECOMMENDED INVESTMENT VEHICLES

Descriptive Quarterly Statistics, as of 9/30/12

Security Symbol	Avg. Market Cap./Avg. Maturity	No. of Holdings	Ratios		P/B	12 Mo. Yield (%)	Annualized Returns <sup>4</sup> (%), as of 9/30/12					
			Expense <sup>3</sup> (%)	Sharpe Turnover (%)			Total 3 yr.	1 yr.	5 yr.	1 yr. After Tax*	3 yr.	5 yr.
<b>Short-/Intermediate Fixed Income</b>												
Vanguard Short-Term Bond Index	2.8 Yrs.	1446	0.22	1.75	67	1.51	2.24	2.98	4.20	1.60	2.23	3.22
iShares Barclays 1-3 Yr. Credit Bond	1.9 Yrs.	777	0.20	1.80	8	1.63	3.17	3.04	4.00	2.57	2.26	2.93
iShares Barclays 1-3 Year Treasury	1.8 Yrs.	51	0.15	1.19	72	0.48	0.44	1.30	2.68	0.27	0.96	2.04
Vanguard Limited-Term Tax-Exempt	2.7 Yrs.	1793	0.20	1.77	14	1.93	2.59	2.63	3.48	2.59	2.63	3.48
SPDR N.B. Short-Term Municipal Bond	3.2 Yrs.	394	0.20	1.15	23	1.29	1.96	2.36	--	1.63	2.23	--
<b>Inflation-Protected Fixed Income</b>												
iShares Barclays TIPS Bond	9.2 Yrs.	36	0.20	1.82	15	2.20	8.87	9.10	7.79	8.01	7.96	6.34
Vanguard Inflation-Protected Securities	9.4 Yrs.	34	0.20	1.82	28	2.27	8.89	9.16	7.61	7.98	8.00	6.49
<b>Real Estate</b>												
VNQ <sup>1</sup> / VGSIX	8.16 B	119	0.24	1.06	10	3.23	32.16	20.30	2.55	30.77	19.04	1.31
SPDR Dow Jones REIT	9.36 B	84	0.25	1.05	7	3.05	31.65	20.25	1.60	30.20	18.91	0.25
<b>U.S. Large Cap Value</b>												
Vanguard Value Index	45.13 B	432	0.24	0.76	23	2.46	28.24	11.18	-1.10	27.75	10.76	-1.51
iShares Russell 1000 Value Index	37.60 B	692	0.20	0.76	21	2.22	30.61	11.63	-1.01	29.72	11.13	-1.45
<b>U.S. Small Cap Value</b>												
iShares Russell Microcap Index	0.26 B	1340	0.60	0.59	31	1.44	36.07	11.46	-0.68	35.43	11.16	-0.91
Vanguard Small-Cap Value Index	1.33 B	1023	0.24	0.68	30	1.80	31.85	12.43	2.48	31.29	12.00	2.02
<b>U.S. Large Cap Growth</b>												
iShares Russell 1000 Growth Index	48.47 B	569	0.20	0.92	19	1.37	28.92	14.51	3.07	28.37	14.19	2.81
Vanguard Growth Index	45.05 B	413	0.24	0.92	23	1.08	31.08	14.90	3.39	30.86	14.71	3.22
<b>U.S. Marketwide</b>												
Vanguard Total Stock Market Index	30.51 B	3313	0.17	0.84	5	1.76	30.09	13.25	1.46	29.73	12.94	1.16
Fidelity Spartan Total Market Index	32.18 B	3294	0.10	0.85	17	1.59	30.16	13.35	1.44	29.80	13.03	1.11
<b>Foreign-Developed Markets</b>												
iShares MSCI EAFE Growth Index	26.29 B	540	0.40	0.30	26	2.44	14.51	4.10	-4.32	13.71	3.77	-4.56
iShares MSCI EAFE Value Index	32.98 B	505	0.40	0.10	27	4.34	12.46	-0.18	-6.36	11.11	-0.74	-6.86
Vanguard MSCI EAFE	27.64 B	893	0.11	0.19	5	5.31	14.71	2.11	-5.05	13.99	1.75	-5.35
Vanguard Developed Markets Index	27.55 B	939	0.20	0.20	5	3.28	14.91	2.16	-5.16	14.25	1.73	-5.69
SPDR S&P International Small Cap	0.95 B	729	0.59	0.33	22	2.71	10.74	5.21	-3.17	10.03	4.74	-3.61
<b>Foreign-Emerging Markets</b>												
Vanguard Emerging Market Stock Idx	18.20 B	891	0.33	0.33	10	3.18	17.74	5.09	-1.73	17.06	4.73	-2.12

Recommended Gold-Mining Companies (\$)

Ticker Symbol	Month 10/15/12	Year Earlier	52-Week		Dividends Paid Last 12 Months	Payment Schedule	Yield (%)
			High	Low			
IAU <sup>1</sup>	--	1	0.25	1.02	--	9.30	20.43
GLD <sup>1</sup>	--	1	0.40	1.01	--	9.20	20.80
AU	34.06	35.79	42.49	49.14	0.6118	1.7962	18.65
ABX	38.84	42.38	48.24	53.26	0.5950	1.5319	18.57
GFI	12.12	12.90	15.59	18.39	0.4963	4.0949	20.80
GG	43.43	46.20	48.38	54.14	0.4497	1.0353	17.06
NEM	54.60	57.20	66.86	72.42	1.4000	2.5641	17.74

Data provided by the funds and Morningstar. <sup>1</sup>Exchange Traded Fund, traded on NYSE. <sup>2</sup>0.5% fee for redemption in 90 days. <sup>3</sup>For Vanguard funds, Expense Ratios shown are for Mutual Funds. ETFs have lower expenses. <sup>4</sup>For Vanguard Funds, returns shown are for Mutual Funds; ETFs' returns may deviate \*Pre-liquidation. Calculated using the highest individual federal income tax rates in effect at the time of each distribution and do not reflect the impact of state and local taxes and individual tax situations. † Dividend shown is after 15% Canadian tax withholding.

The information herein is derived from generally reliable sources, but cannot be guaranteed. American Investment Services, the American Institute for Economic Research, and the officers, employees, or other persons affiliated with either organization may, from time to time have positions in the investments referred to herein.