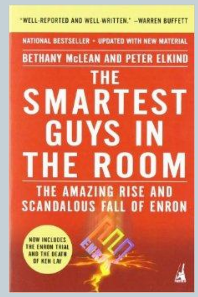
The Tale of Enron

WHAT "THE SMARTEST GUYS IN A ROOM" CAN TEACH US ABOUT CONCENTRATIONS!



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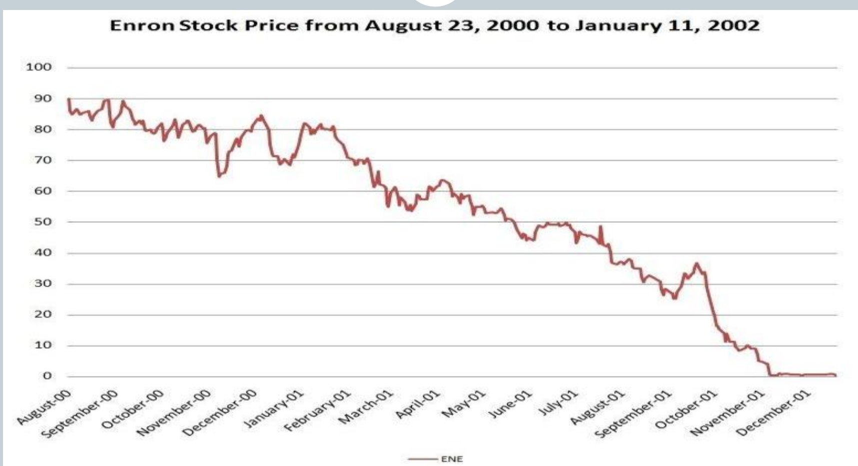
Enron Stock



Bank of America

AIG Stock

Overview

- DEFINE the Duty of Prudence
- Clarify the role of asset allocation as the MAJOR driver of account performance
- Explain the importance of DIVERSIFICATION across sectors, industries and asset classes
- Discuss how to effectively reduce concentration RISK while managing taxes and emotional attachments

Perils of Asset Concentration

- U.S. seeing a rise in the number of lawsuits against trustee's concerning concentrated positions
- Notable cases:
  - Knox family trust, where trustee failed to diversify out of Woolworth and HSBC
  - Dumont Trust funded entirely of Kodak stock with a retention clause and Chase chose to retain
- Breaching the Duty of Prudence - Uniform Prudent Investor Act requires diversification

Prudent Man/Investor Rule

- Observe how men of PRUDENCE, discretion and intelligence manage their own affairs, not in regard to speculation but in regard to PERMANENT DISPOSITION of their funds
- Entire portfolio is considered
- Diversification is explicitly required
- No category or type of investment is deemed inherently imprudent
- A fiduciary is permitted to delegate investment management

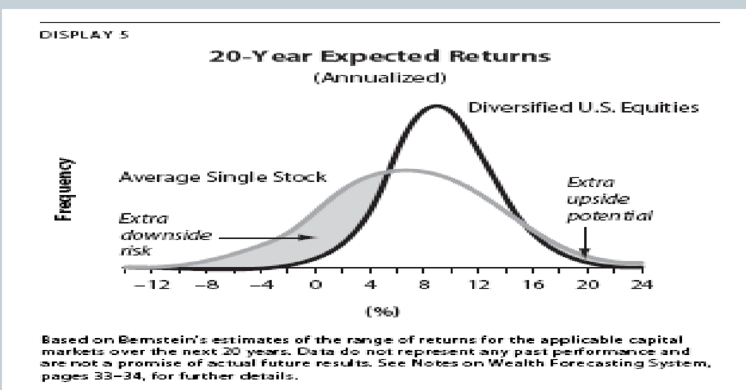
Trustee's Investment Challenge

- Acquisition of a non-diversified portfolio
  - Unapproved assets
  - Positions with sizable gains
  - Emotional attachment
  - Concentrated positions

Return Expectations

- Bernstein's showed the average compound return generated by a single stock is likely to be lower than a diversified portfolio
- A single stock return tends to be far less predictable than a diversified portfolio
- The potential for a single stock to perform better than a diversified portfolio is small. *"Investor may get paid more for taking extra risk but the odds are stacked against them*"

Expected Return



General Guideline for Trustee's to Limit Uncompensated Risk

- The more volatile the stock the greater the risk borne by the portfolio and the lower the long term growth – higher sale amount is prudent
- The shorter the time horizon - higher benefit of staged selling to sell down the position
- The lower the cost basis – a benefit of staged selling over a longer time period to manage tax liability

Options for Concentrated Positions

- Hold
- Sell all upfront
- Staged selling
- Hedge
- Other
  - Gifting
  - Charitable Remainder Trusts

Driver of Portfolio Returns

- Strategic asset allocation mix is the major driver of variability of returns✓
- Tactical asset allocation ×
- Individual security selection ×
- Other ×

Key Determinates for Asset Allocation

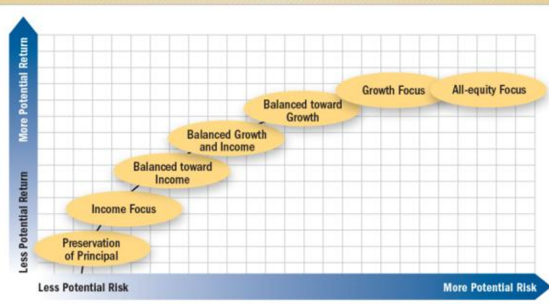
- Identify investors goals and objectives
- Quantify income needs
- Define time horizon
- Determine investors tolerance for risk
- Ascertain tax position
- Discuss investors interest in leaving a legacy

Sample Asset Allocation Guidelines

	Balanced toward Income	Balanced Growth & Income	Balanced toward Growth
Equity Targets	**35**	**50**	**65**
Equity Ranges	25-40	40-55	55-70
Aggressive Growth Targets	**2**	**5**	**10**
Aggressive Growth Ranges	0-5	0-15	5-15
Growth Targets	**8**	**15**	**25**
Growth Ranges	0-15	10-25	15-35
Growth and Income Targets	**25**	**30**	**30**
Growth and Income Ranges	20-40	25-40	25-40
If Using Real Estate Mutual Funds	0-3	0-4	0-5
Fixed-income Targets	**60**	**45**	**30**
Fixed-income Ranges	55-70	40-55	25-40
Aggressive Income (High Yield)	0-10	0-10	0-10
Cash Targets	**5**	**5**	**5**
Cash Ranges	0-10	0-10	0-10

Portfolio Objective

PORTFOLIO OBJECTIVE: HISTORICAL PERFORMANCE



Portfolio Construction Guiding Principles

- Long-term focus on investing
- Diversification among asset classes:
  - Equities: Diversified by size (market capital-small, mid and large cap), investment style (growth vs. value), geography (domestic, international –developed or emerging market), and industry sectors
  - Fixed Income: Laddered portfolio of domestic and international securities diversified by sector and geography and quality.

Questions

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