Jeff Lydenberg - Sat, 2/20/2016 - 10:49

The year ending December 31, 2015 was historic and monumental - the earth shifted violently beneath our feet, rivers changed courses, truisms were shattered, and fear was pervasive. Desperate times drove desperate actions, and good men and women scrambled in panic to find stable ground. It suddenly seemed that nothing was safe anymore. *No, we're not talking about the presidential race – we're talking about the U.S. stock market.* For the first time in seven years, the stock market didn't end the year ahead of where it started. Of the three major U.S. stock indices, two of them ended the year below their price levels on January 1. Flashbacks to 2008 and the Great Recession ensue.

After so many years of positive returns, we saw a perceived "down year" for both the Dow Jones Industrial Average ("the Dow") and the Standard & Poor's 500 Index ("S&P 500") – and these are probably the two most widely-quoted indicators of the stock markets. The S&P 500 loss was minimal at .7%, but the Dow loss was significant at 2.2%. Keep in mind, these numbers are "price only" – they do not include the income earned through dividends in these hypothetical stock bundles. The *total* returns for these indices were just enough higher for 2015 to be "flat for the year," roughly speaking, rather than down but most references to the indices are using the price only values.

The first month of 2016 proved even worse. All three major indices experienced significant losses in January. The S&P 500 was down 5.1%, the Dow was down 5.5%, and NASDAQ was down 7.9%. By the beginning of February, there was no denying the seismic shift we had experienced; we were now solidly in "market correction" mode. From the high points reached at various times in 2015, the standard market indices had fallen 10 to 15%. *One step short (another 5 - 10% decline) of a bear market*, according to many commonly-used measures.

While values for stocks are always going up and down, this is a big deal. For the first time since 2008, on average, stockholders are seeing losses in the values of their holdings. To be fair, some investors may have held stock portfolios that performed better than the indices – remember the indices are averages – but that means some investors held stock portfolios that did much worse. Take energy sector stocks as an example – as the price of oil continues to plummet, the stockholders of oil and energy companies are suffering brutal declines in their portfolio values.

For many investors, the losses are what we call “paper losses.” Anyone holding portfolios for the long term – and this would certainly include the trillions of dollars held in retirement accounts – there is much faith that we are in yet another portion of the economic cycle and that eventually prices will rise again. But important for those of us in planned giving is the*perception, in the minds of many donors, that they are worse off today than they were a year ago*.

For retired persons whose wealth is held primarily in retirement funds and personal investment portfolios, the rate of increase or decrease in their total wealth from year to year is critically important in their ability to sustain their lifestyles for their remaining years. If they perceive that their investments are losing value now instead of gaining value, they will be much more likely to hold off making substantial charitable gifts. And fear of a return to the bleak years of 2007 through 2009 amplifies serious doubts of future improvement for many potential donors.

These considerations seem to play out especially in the case of planned giving donors, who tend not to be in the top 1%, but rather, tend to be in the top 5% or 10% of income and wealth concentrations.

So, how do you encourage the perception that making a planned gift in times of market turbulence is still in the interest of the donor?

Flexibility and Risk Reduction Are the Keys!
Retired investors want to protect their principal and rely mainly on income from their investments to maintain their lifestyle. The market volatility described above can negatively affect both dividends and bond yields. As such, planned gifts offering a combination of steady payments and generous income tax charitable deductions are going to best suit donors in times of volatility, especially *planned gifts that offer the least risk and the most flexibility*.

Gift Annuities
A gift annuity offers a fixed payment guaranteed by all of the charity’s assets. The annuity can’t run out of money unless the entire charity does, the payments last for life, and the older the annuitant, the higher the rate! ACGA gift annuity rates top out at 9% for the oldest annuitants, and a 9% payment is very attractive in today’s

economy.

A gift annuity pays a fixed payment that is not tied to the investment performance of the donated assets. The charity is contractually obligated to make the payments so the annuity payments are insulated from volatility. The older the annuitant, the higher the payment, but once payments begin there is no adjustment. In a high inflation economy, the value of a fixed payment would be eroded over time as the cost of goods and services increase. In an economy such as we are experiencing now, due to low inflation, the purchasing power of the fixed annuity payments is much less affected by increasing prices of goods and services.

Bequests and Beneficiary Designations

Gift annuitants enjoy the security of reliable payments. But what if an annuitant decides she needs her money back? There could be medical expenses, unexpected needs or any number of situations when the donor wants her principal back. Although a gift annuity offers a dependable stream of payments, it is an irrevocable gift.

The gift plan with the ultimate in flexibility is the bequest or beneficiary designation. The combination of market volatility and the desire to access principal makes the gift vehicle of choice a revocable gift that is only effective at the death of the donor. Such a gift can be expressed as a percentage of the assets remaining at the donor’s death. The size of the gift fluctuates with the size of the donor’s estate at death.

Revocable commitments such as bequests and beneficiary designations can also be contingent on certain conditions being met. For example, a bequest establishing an endowed scholarship could be made contingent on a minimum amount left for heirs. If the amount left for heirs is below the floor set by the donor, the charitable bequest fails. A significant concern for many is that their heirs are provided for first. A contingent charitable bequest offers the flexibility to ensure that benefits to family have priority over benefits to charity. A contingency can remove the uncertainty inherent in long-range planning.

CRTs Help with Diversification and Capital Gain Tax Reduction

Another way to deal with volatility is to diversify. The wealth owned by many planned giving donors may be concentrated in the stock of the company where they spent their careers. Thousands if not millions of shares of General Electric are owned by retired employees for example. These securities were probably acquired on very favorable terms. Nonetheless, concentration of ownership in one stock, plus the significant appreciation in value in these securities can create investment and tax problems for the retiree.

Funding a charitable remainder trust with highly appreciated stock can solve capital gain tax problems and allow tax-efficient investment diversification. Since a charitable remainder trust is a tax-exempt vehicle, the trust can sell appreciated assets without incurring an immediate capital gain to the donor. The complete value of the assets donated to the trust is available for investment undiminished by the immediate payment of capital gain tax. To the extent capital gain income is paid to the donor, it is spread out over time. And a tax deferred is a tax reduced because of the time value of money.

Since a charitable remainder trust can sell appreciated assets without incurring immediate capital gain tax, the trustee can sell securities and diversify the trust's investments without worrying about capital gain tax. In the example of employee owned stock in one company, the risk of concentrated stock ownership is eliminated in a tax-efficient way that minimizes capital gain that might otherwise be due.

Conclusion
For many planned giving age donors, volatility of investments will continue to be a major concern. Planned gift solutions that offer maximum flexibility like bequests and beneficiary designations can be appealing to those concerned about outliving their resources. Gift annuities offer reliable fixed payments at attractive rates that can reduce the impact of volatility on a donor's income. Charitable remainder trusts can offer ways to diversify portfolios and minimize capital gain tax consequences at the same time.

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