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It goes without saying that investors have had to put up with a lot of bad news recently. In the last three months markets have absorbed the first-ever downgrade of US debt, the lingering debt crisis turned pandemic in Europe, and sharply increased global recession fears. Equity markets responded by falling to bear market levels (a 20% decline from the peak) in September, followed by sharp gains in October on positive economic reports, strong corporate earnings, and favorable action in the euro-zone to contain the debt crisis to a handful of countries. Clearly, emotion and sentiment are exerting a big influence on prices, and we expect volatility will remain elevated as equity markets continue to wrestle with the uneven economic recovery and rapidly unfolding situation in Europe.

In this issue of *Insight*, our Chief Investment Officer, Jason Thomas, addresses the crisis in Europe and the potential unfolding period of economic stagnation in some developed economies. While volatile markets are uncomfortable, the current environment has also created some opportunities for smart adjustments to investment portfolios as well as possible financial planning decisions. We'll discuss some changes that Aspiriant is making in the implementation of clients' bond and real estate allocations, and Sandi Bragar explores how this may be a particularly opportune time for parents to assist their children with purchasing a home. Finally, as we approach year-end, we summarize some of the work we're doing on behalf of clients and highlight a few opportunities for minimizing your 2011 tax liability.

As you read through this *Insight* we invite you reach out to your Aspiriant team to further explore any of these ideas and how they might apply to you and your family.

No Easy Answers for the Euro Zone

Until recently, the risk of another acute financial crisis similar to the bankruptcy of Lehman Brothers seemed minimal. But the failure of Europe's leaders to aggressively address Greece's financial problems has allowed the strains to spread throughout the euro-zone. European bankers have admitted that a Greek default (or even revaluing Greek bonds at their market prices) might wipe out all of their equity … and then some. Governments once again have to step in to support their banks, including Dexia, a lender that was bailed out three years ago but which is now weighed down by Greek, Spanish and Italian debt. The amount of money parked at the European Central Bank (ECB) has risen to 15-month highs as banks refrain from lending to each other as the result of these concerns.

Some progress is being made …

Will the challenges of 2011 be allowed to cause another crisis like 2008? In any sensible world, it should not. European policymakers should surely not repeat the mistakes of American leaders in 2008, letting a big financial institution collapse. The investments in the crosshairs this time — sovereign debt — are far easier to value and support than the securitized subprime mortgages at the heart of the last crisis.

The problem this time is that an effective response depends upon a less cohesive European political and financial structure to carry it out. The European debt crisis has been rumbling for 18 months with astoundingly little progress. Markets had hoped that the series of meetings at the end of October would deliver a comprehensive program of measures to address the European financial crisis:

(1) bank recapitalizations,
(2) a more aggressive reduction (of 50%) on Greek government debt,
(3) an insurance program to guarantee the first loss on sovereign debt underwritten by the European Financial Stability Facility, and
(4) announcements of institutional reforms to Euro area governance.

Despite the market rally on news of a deal, closer inspection revealed more questions than answers. The result could be the worst of all outcomes: more uncertainty for banks that hold Greek debt and more counterproductive austerity for the battered Greek economy.

… but the current steps are unlikely to "solve" the problems.

While these measures are needed, they will likely not resolve the current financial tensions and political impasse. Recapitalizations will likely address investors' near-term concerns about the strength of European banks, but no amount of recapitalization would be enough to protect banks from a cascade of euro-zone defaults. It seems clear that nothing matters more than avoiding the spread of default from Greece to Spain and Italy, but the ECB seems unwilling to respond. In 2008, governments were credible backstops for their banks and the Fed was creative and persistent in its efforts to instill confidence. Now the governments themselves are the problem and the ECB's help is limited and conditional.

Despite the reasons for disappointment, we firmly believe that the current financial crisis will be addressed. Ironically, the more acute the panic, the more likely a plan will be passed. But from the perspective of investment portfolios, the agreement is unlikely to meaningfully alter the backdrop of deleveraging and weak economic growth in Europe and throughout the developed world. This trend is likely to be far more important to capital market returns than any short-term fix in Europe. No matter how the European rescue plan is implemented, deleveraging and asset sales (sometimes at fire sale prices), low interest rates, slower developed market growth and reliance on demand from emerging markets will continue to be the defining features of the macroeconomic landscape.

Stagnations are not uncommon …

In a recent paper[1], Goldman Sachs looked at periods of prolonged sluggish growth ("stagnations") and found that such periods have been quite common through history. Periods of stagnation, commonly associated with Japan's economy in the 1990s, are much more common than is generally thought. Defining stagnation as a period of sub-par growth in GDP per capita that was not interrupted by a recovery to trend growth or by a sharp contraction, Goldman Sachs looked at more than 100 years of history and found 93 episodes, worldwide, that fit this description for more than six years and around 20 that lasted longer than a decade.

Stagnations tend to be characterized not just by sluggish growth but also by high and sticky unemployment and lower inflation. Based on these observations, they conclude that the

1 Goldman Sachs, "From the 'Great Recession' to the 'Great Stagnation'?", *Global Economics Weekly,* September 28, 2011.

risk of a Great Stagnation is significantly higher than normal for the major developed economies, at around 40%.

… and offer similar market return profiles.

The stagnations were characterized, on average, by lower equity returns and higher bond returns than normal. Where stagnations are preceded by banking crises, these tendencies are even stronger.

For equities, the returns during a typical stagnation are lower than normal, averaging around 5% per year. That compares to a full sample historical mean of around 8% and a post-World War II average close to 11%. T-bill returns were generally not that different from the normal experience, although they were somewhat higher for the longest-lasting stagnations. Bond returns were generally significantly higher, with the average stagnation experience higher than both the historical and the post-WWII means (at 3.0% and 2.5%, respectively). These bond returns were heavily impacted by the starting level of interest rates, suggesting that bond returns during any stagnation starting from today would be lower than average[2].

An important message to investors is that while the average investment environment during stagnations has been more bond-friendly and less equity-friendly than normal, it has been less negative than the Japanese experience on its own would indicate. This suggests that the biggest threat to capital markets is still more likely to come from another recession or financial crisis than from even a prolonged period of sluggish growth.

Moreover, stagnations do not last forever and are typically contained to a small number of economies that are unwinding past financial excesses. In our August *Insight* we discuss our expectation that emerging economies are likely to experience rapid economic growth, while more developed economies such as Western Europe and the US are facing significant headwinds to growth on account of high public and private debt, large social program liabilities, aging infrastructure and unfavorable demographics. Our 2011 capital market expectations project strong economic growth and equity returns worldwide over the next 20 years but, clearly, the next several years could be marked by below-average growth in the developed world.

So current portfolio risks stem primarily from two issues.

Since stagnations are not generally catastrophic for capital market returns, we think the primary portfolio risks stem from two other unlikely possibilities. A slip into renewed recession or an intensified financial crisis in Europe are the dominant risks to market returns and the largest source of volatility in financial markets currently. We think that the global economy will avoid both of these two outcomes, but until those fears have been put to rest or the risks diminished, it will be hard for markets to move decisively upward.

The second near-term risk is created by the lack of philosophical consensus and political will to address the problems in the global economy. A number of key features of the Japanese experience do not characterize the current situation – for example, the valuation of equity markets in 2007 did not compare to the overvaluation of the Japanese equity markets at the height of the Japanese bubble; and even in housing, the extent of excess in the US was nothing like Japan in 1990. However, there are clear parallels in the low starting point for inflation and interest rates. Deflation and inadequate stimulus intensified the Japanese downturn and, to the extent policymakers repeat those mistakes, could exacerbate the stagnation in the US and Europe.

In the end, we will collectively resolve the crisis.

As investors, we need to derive wisdom from past experience without relying on hope or averages and probabilities. We do have hope and recognize the probabilities, but both of those are based on our research and actual experience. The fact is that the world has faced incredible financial stress and social upheaval in the past, but the human drive and capacity for adaptation and innovation is resilient. The global economy will return to health and the markets will begin providing attractive returns prior to that.

Our key challenge as investment managers is to find a way to remain invested, achieving the returns in the short-run if possible, while mitigating the extreme downside risk. That continues to be the primary focus of our investment team.

Jason Thomas, Ph.D., CFA

Chief Investment Officer

2 Past performance is not indicative of future results.

Leaving the Nest: Helping Your Child Purchase a Home

With housing prices still depressed in many areas across the country and mortgage interest rates at all time lows, clients look to us for advice on how best to help their children purchase a home. The available strategies span a range including outright cash gifts, low-interest rate family loans, co-ownership, and trust arrangements. This article introduces some of the more popular strategies.

First things first

Assisting a child with the purchase of a home is often one of the most rewarding things that parents can do, but it requires careful and thoughtful planning. So, before discussing any specific strategies, it's important to first examine the parents' intent and understand how helping a child or children with a home purchase fits into the long-range planning for both the parents and the children.

First there's the question of affordability for both the parents and child. Helping a child purchase a home is typically an expensive goal, and it's important that the parents understand the impact on their other financial decisions. The parents' own constraints and the priority of their other goals (e.g., lifestyle, philanthropy) might shape the amount and type of assistance they provide.

We must also consider the child's ability to maintain the home on an ongoing basis. Receiving a home or a large down payment is certainly a nice gift, but if it saddles the child with ongoing expenses that they cannot comfortably afford (e.g., mortgage payments, property taxes, utilities, maintenance), it can become a burden and impair their financial flexibility.

Providing assistance to a child can also set expectations with other children that they will be treated similarly, which potentially increases the financial burden on the parents and can create some uncomfortable family dynamics.

Answering these and other questions is key to making the assistance fulfilling for both the parents and the child.

Direct gifts

The most straightforward way to help your child buy a home, whether it's a starter abode or a dream home that they expect to own forever, is to make a cash gift directly to the child, which he or she applies toward the home purchase. With the lifetime gift tax exclusion limit at $5M per person through 2012, this is a simple and effective solution for many clients.

Parents with sufficient resources can make a gift large enough to enable the child to purchase the home outright. More commonly, however, clients help with a down payment, and they'll often tailor the gift around how much mortgage the child can comfortably afford. Unless the child has other assets to contribute toward the purchase, the clients will often give at least 20% of the purchase price, with the child financing up to 80%.

In these situations, it's important that the child can qualify for and comfortably service a mortgage, so the decisions of mortgage principal amount, repayment terms and type of loan are important. Mortgages are priced in three tiers, and within each tier there are a variety of mortgage products with rates fixed anywhere from five years to 30 years.

	Maximum Mortgage Balance	November, 2011 Sample Prices	Underwriting
Conforming	$417,000	2.62% - 4.2%	Strict – FNMA
High Balance Conforming	$417,000 - $625,500 [1]	2.75% - 4.45%	Strict – FNMA
Jumbo	$625,500+	2.875% - 4.625%	Lender's process

[1] Depending on the county in which the house is located.

Obtaining a mortgage in the current environment can be challenging, particularly for borrowers with few assets, a short work history, or spotty credit, all of which are common among younger borrowers. This is particularly true when FNMA underwriting is involved (i.e., most fixed-rate mortgages). If the child cannot qualify for a mortgage on his or her own, the parents will often assist by serving as a co-borrower on the loan.

Parents as "the bank"

Another common way for parents to help a child purchase a home is to lend the child money at a lower rate than banks charge. Each month the IRS publishes minimum interest rates for related-party loans. So long as the loan requires interest payments at a rate equal to or greater than the minimum, no gift tax issues arise as a result of the loan. These rates, known as AFR rates, are based on the term of the loan, and are currently at historic lows:

	Long Term	AFR Rates for November 2011
Short-term AFR	Less than 3 years	0.19%
Mid-term AFR	3 – 9 years	1.20%
Long-term AFR	More than 9 years	2.67%

Intra-family loans can have all of the key features of a regular mortgage (e.g., interest-only or amortizing payments, tax-deductible interest, no prepayment penalty) but at rates that are much more affordable than conventional bank financing. And intra-family loans can be combined with conventional financing, for example, if the child makes a 10% down payment, obtains a mortgage for 80% of the purchase price, and borrows the remaining 10% from the parents.

This strategy is particularly attractive for parents who cannot afford to make outright gifts, since the child pays interest and principal over time. Over the course of the loan, the parents earn a below-market interest rate, so it does carry an opportunity cost, but the cost is much less than that of an outright gift. If affordable, parents often use the $13,000 annual gift tax exclusion to forgive the interest and principal on the loan over time. A mother and father, for example, can *each* give a child *and* their spouse $13,000/yr, so a total of $52,000/yr of annual exclusion gifts, which could be used to retire loan principal and interest. In this way, the parents have accomplished their goal of transferring wealth to their children but have preserved their entire $5m lifetime credit.

Joined at the house: co-purchase and co-ownership

Another alternative to an outright gift or a loan is for the parent to co-purchasing a home with the child. This approach is particularly helpful for parents who can't afford to, or do not want to, make an outright gift to the child, or for those parents who want to retain some control over the property for some period of time. In many cases, the parents expect that the child will eventually buy out their portion of the ownership as their career progresses and they have the financial capacity.

Clear bookkeeping is a must for this strategy, as the co-owners each cover their proportional share of the home-related expenses (e.g., property taxes, insurance, improvements). These situations also require a tenancy-in-common agreement specifying the responsibilities and expectations of the co-owners and planning for contingencies such as the death, divorce or bankruptcy of any owner.

Co-ownership is a hybrid between a co-purchase arrangement and an outright gift. Typically, the parents will buy the house and give a minority interest to the child or to a trust for the child's benefit. This arrangement reduces the taxable gift associated with an outright cash gift and carries the same benefits and responsibilities of a co-purchase arrangement.

Advanced strategies

Families with resources over $5 million per parent will likely pay estate taxes upon the death of the second spouse and, consequently, could benefit from strategies that preserve as much of each parent's $5 million lifetime exemption as possible. One common strategy involves the parents establishing a trust for their child, making a small cash gift to the trust, and then having the trust purchase the home for the child's benefit. This provides the parents with some level of control and also protects the home from the child's creditors or a failed marriage. Compared to a direct gift of cash, using a trust can also minimize the use of the $5 million lifetime credit, leaving more of the credit available to offset future estate taxes and allow future wealth transfer planning.

One common trust strategy, called a "sale to a defective grantor trust", gives parents the opportunity to transfer a home (and, if desired, investment assets) to children for their lifetimes and then gift tax free to *grandchildren*.

Our goal as financial planners is to develop a strategy that works best for your family's unique facts and circumstances. If you're contemplating helping your child or children purchase a home of their own, either now or some time down the road, we can help you craft a plan that's optimal for your family.

Sandi Bragar, CFP

Thanks Mom and Pop: Finding Value in the Municipal Bond Market

The primary role of bonds in Aspiriant portfolios is to reduce volatility, but investors should also expect to receive fair compensation for the use of their capital. Bonds can achieve impressive returns, typically during periods of falling interest rates, but we have historically been reluctant to accept the significant interest rate or credit risk needed to generate strong bond returns over time. Instead, we have traditionally minimized risk in the bond component and allocated risk to asset classes such as equities which we expect to offer a higher long-term rate of return. In the last few months, however, we have identified an opportunity in the municipal bond space, which we find compelling enough to somewhat adjust our approach to fixed-income investing for clients who hold fixed-income in taxable accounts.

Telegraphing monetary policy

In August, the Federal Reserve committed to keeping the Fed Funds rate near zero for the next two years. This announcement, combined with weak global economic growth and concerns about the European financial system, caused the prices of US Treasury securities (USTs) to rise, with yields falling to new lows. This made USTs and other bonds which are priced relative to USTs (e.g., corporate bonds) even less attractive in our view. The extremely low current interest rate environment does not bode well for bond returns over the coming years as interest rates rise and put downward pressure on bond prices.

Can the new gold rush last?

The renewed concerns about the global financial system have put gold into the spotlight recently. Here we review our thoughts on gold and the role gold plays in Aspiriant portfolios.

Gold has historically not been a good investment …

Gold gets a lot of attention when the markets are concerned about paper currency, but gold has not historically had good returns, in part because it does not offer any yield (unlike, say, T-bills). The price of gold dropped steadily from a January 1980 peak of $2,403 (in 2011 dollars) to a recent low of $345 in 1999. In the last 10 years ending December 2010, however, gold has performed very well, achieving returns of more than 17% in 7 of 10 years. We believe this reflects some investors' overwhelming desire for a haven from equity markets and financial crises and will likely reverse as the global economy finds its footing.

… or a good inflation hedge.

Interestingly, though gold is often described as a hedge against inflation, the return to gold has beaten *realized* inflation only about 50% of the time. Gold performs well during financial crises, but not necessarily well during periods of generalized inflation, especially if interest rates rise (making the opportunity cost of holding gold higher).

Gold does respond to changes in *expected* inflation, and had a correlation of 0.53 with the Barclays Capital U.S. Treasury Inflation Protected Securities (TIPS) Index over the past three years ending October 31, 2011 (since the financial crisis began in September 2008). This is somewhat higher than the correlation of 0.42 between TIPS and the broader S&P Goldman Sachs Commodity Index over the same period.

Implications for client portfolios

Aspiriant portfolios that include an allocation to commodities futures own a small amount of gold as part of the commodities implementation and additional exposure to gold in the public equity implementation through gold mining companies. We believe that an outsized allocation to gold as a hedge against financial crisis, like an insurance policy with no deductible, is prohibitively expensive. As described elsewhere in this *Insight*, we believe there are more cost effective ways to manage risk.

The municipal bond market, however, did not benefit from the UST rally; on the contrary, municipal yields rose slightly, particularly for long duration and high yield municipal bonds. We believe this disconnect, which has now persisted since the financial crisis in late 2008, creates an attractive opportunity for fixed income investors with a higher risk tolerance and capacity than the average mom-and-pop municipal bond investor.

The additional compensation earned for taking risk across the municipal spectrum (municipals vs. USTs, long vs. short duration, high quality vs. lower-quality securities) is very attractive relative to historical levels (more on this below) and relative to our assessment of the risk in the municipal bond sector. By most measures, municipal and state governments have continued to get their fiscal houses in order over the last couple of years, which reduces the risk of default; however, as we argue below, municipal bond prices do not yet appear to reflect the substantial improvement in financial condition.

Aspiriant has therefore changed our tax-exempt fixed income allocation to reflect the current conditions in the municipal bond market, increasing the allocation to longer duration and higher yielding bonds *and* comparatively stable very short term municipals (this is sometimes referred to as a "barbell" approach). The result is a fixed-income implementation that we believe has a similar risk profile to the current implementation, but with a somewhat higher expected return. These changes are, in part, opportunistic, with the expectation that we will reduce these exposures when valuations in the municipal bond market return to more normal relationships.

The role of high yield municipal bonds

The municipal bond market is very diverse and resists broad generalizations. Some reports put the number of municipal bond issuers at over 50,000, with millions of unique securities making up almost $3 trillion in value. Fewer than one-third of municipal bonds outstanding are the direct "general obligation" debt of state and local governments. Most of the remainder are "revenue" bonds, which use revenue from specific assets to repay bond holders. About half of these revenue bonds are issued by utilities with rate-setting powers which are therefore generally less impacted by recessions. Many universities,

endowments, hospitals, and toll roads also issue tax-exempt revenue bonds.

While revenue bonds entail more credit risk because they are not backed by the full credit of a state or city, in some ways revenue bonds are more transparent than general obligation bonds. Like corporate bonds, revenue bonds have an identifiable source of cash flow and often have bondholder protections such as asset collateral which can be sold in the event of default.

We believe the current municipal bond market provides exactly the kind of opportunity which Aspiriant's investment platform was designed to identify and achieve — tens of thousands of unique securities, little institutional following (particularly after the collapse of Lehman Brothers in 2008), and yields at historical highs relative to more "mainstream" bonds. However, the typical municipal investor does not have the capacity to evaluate (especially high yield) revenue bonds, creating an opportunity for institutional investors and sophisticated individual investors to earn strong risk-adjusted returns.

Implications for client portfolios

The fundamental truth of investing is that we must be willing to take risk to achieve a return. Of course, the primary purpose of the bond component in Aspiriant portfolios is to mitigate portfolio risk, with the secondary (but still important) objective of receiving a fair return on capital. It is our job to balance these (often competing) objectives, and in doing so we must ask ourselves whether all of the factors discussed above are reflected (albeit imperfectly) in market prices. That is, do the returns offered sufficiently compensate for the risks that are present?

Assuming a bond is held to maturity (i.e., putting aside any potential short-term trading opportunities) and the issuer pays in full, the total return of a bond is largely known at purchase. The pricing of the interest rate and credit risks of a bond (the "spread" between the municipal bond and similar duration Treasuries) therefore gives much more information about the likely total return of a bond than the pricing of equity risk (the price/earnings ratio, for example) gives information about the likely future return of a stock.

Are the spreads attractive enough to bear the risk of longer maturity and lower quality municipal bonds? Municipal bond spreads spiked to extreme levels in 2008 around the time of the financial crisis, which saw the implosion of the world's largest muni bond dealer (Lehman) and several

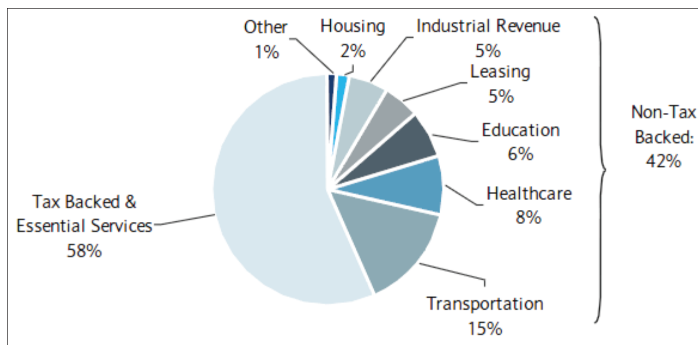
large hedge funds that had made unsuccessful stock bets and were forced to sell their muni bonds at fire sale prices. While the muni bond market has moderated from the extreme levels in 2008, by almost every measure municipal bonds are priced attractively relative to US Treasuries and US corporate bonds (see chart above).

With fear among retail investors dominating the current municipal bond environment, opportunity arises for a more sophisticated approach. At this point, the longer the maturity and lower the credit quality of a municipal bond, the more attractive its price relative to historical averages.

Our confidence in this approach to municipal bonds is further bolstered by the diversity of the municipal market and the absence of the kind of interdependence which drove the financial crisis in September 2008. In many cases, a single municipality will issue several series of bonds, each supported by a different source of revenue. For example, the same city might issue general obligation bonds, utility revenue bonds, and bonds supported by a first lien on a

citywide sales tax. Although the credit quality of each of the bonds is largely affected by the local economy, unique factors will influence the specific repayment scenarios. As the chart below displays, less than 60% of the municipal bond market is backed by taxes, so an investment approach which focuses only on tax-backed and essential service bonds would leave out over 40% of the investment opportunity set.

Market value % by source and purpose for Barclays Capital High Grade Municipal, High Yield Municipal, and Municipal Taxable Indices.



Source: Bloomberg, Barclays Capital.

Strong partners

Aspiriant implements the fixed-income allocation with two partners – Vanguard and Nuveen. Vanguard, a longtime partner of Aspiriant clients, provides very low cost, broadly-diversified exposure to bond markets, which is ideal for the shorter end of the spectrum designed to mitigate volatility.

We have hired Nuveen Investments to help us sort through and capitalize on the opportunity in the large and misunderstood market for higher yield municipals. We believe that Nuveen, also a familiar name in Aspiriant portfolios, has the best municipal credit research department in the industry, with twice as many credit analysts than the next largest firm. Our confidence in them played an important role in our additional allocation to high yield.

Because Aspiriant clients are able to look beyond the headlines and the short-term volatility, we have taken a discerning and analytical approach to bonds. We have developed a structural allocation and implementation which we believe takes advantage of the current environment while standing up well to the cycle of interest rate increases which will eventually arrive.

Jason Thomas, Ph.D., CFA
Chief Investment Officer

Changes to the Real Estate Lineup

Last quarter, the Aspiriant Investment Strategy and Research team completed a comprehensive review of our approach to publicly-traded real estate (REITs), which comprise up to 10% of many clients' portfolios. We have divided the global real estate allocation, previously implemented using the RREEF Global Real Estate Fund (RRGIX), into US and non-US allocations, implemented with two different managers. We implemented these changes in clients' portfolios in October.

US real estate allocations

We can ensure the best possible tax treatment for clients' real estate investments by separating the US from non-US investments; consequently, we decided to split the real estate allocation into two separate funds.

For US real estate allocations, we have chosen the Cohen and Steers Institutional Realty Shares Fund (CRSIX). While we employ a systematic approach in most public asset classes, we have maintained a fundamental active approach in public real estate. Among other reasons, we think that there are important non-public sources of information about real estate (from private real estate investors, for example) which can be profitably incorporated by fund managers. After extensive conversations with RREEF and Cohen and Steers, we found the Cohen and Steers approach more compelling.

Cohen and Steers pioneered the field of REIT investing as the first investment manager dedicated to real estate securities, which has enabled their team to foster relationships with many of the largest public REITs over the course of many years. Cohen and Steers is often the largest investor in their portfolio companies and we believe this gives them the ability to exert their influence on the management teams of their portfolio companies. The clearest illustration of their influence in the industry came at the height of the financial crisis when Cohen and Steers orchestrated the recapitalization of several of the largest REITs. Initially opposed to Cohen and Steers' suggestions, the REITs eventually came to an agreement with Cohen and Steers that recapitalization was vital to their subsequent survival and growth. As companies slowly worked to restructure their balance sheets, Cohen and Steers' participation in the debt and equity offerings of the REITs provided a springboard that ultimately led to a quicker recovery. Over the past 20 years Cohen and Steers has generated consistently strong annualized returns in this strategy and has distinguished itself among its peers.

We still think highly of RREEF, which remains one of the largest investors in public and private real estate in the world. However, the RREEF approach in global markets became oriented toward analyzing countries and currencies as opposed to individual companies. This evolution was apparent in RREEF's performance outside of the US, which showed good stock selection within countries but negative contribution from country and currency selection.

International real estate allocations

As we've written before, we believe that international real estate offers an outstanding growth opportunity in the coming decades. Much like US real estate 30 years ago, the vast majority of commercial real estate outside of the US is privately-owned and thus somewhat insulated from the competitive forces of the marketplace; consequently, much of that real estate is inefficiently managed and undervalued. The introduction of the REIT structure in the US over 30 years ago transformed the commercial real estate market, unleashing a great deal of value as real estate moved from private to public ownership. Many countries in Asia and Europe have created REIT-like structures, and we expect a similar dynamic to play out over the coming decades.

To access this opportunity, we have chosen the SPDR Dow Jones International Real Estate exchange traded fund (RWX), which mirrors the Dow Jones International Real Estate Index. While we acknowledge the non-public information in non-US real estate markets, we believe the geographic and currency risk of the non-US real estate space dominates managers' ability to employ fundamental information. Active managers may be able to identify opportunities based on real estate fundamentals, but our experience suggests that they are not able to successfully allocate among countries and currencies (for which returns are driven by broader, macroeconomic factors). We have therefore decided to index the non-US exposure in order to minimize the management expense while maintaining market weight exposures around the world.

Tax considerations are always an important factor in our investment decisions, but they're particularly important in real estate, which is among the most highly taxed investment asset classes. Most investments in foreign real estate receive particularly onerous tax treatment. We believe the compelling opportunities and benefits of diversification argue strongly for maintaining international real estate exposure despite this adverse tax treatment. To mitigate the tax issue we generally try to hold foreign REITs in clients' tax-exempt accounts like IRAs and retirement plans. The exchange traded fund structure itself also helps to mitigate some of the onerous tax liability issues. An active manager using a traditional mutual fund format, in contrast, would face comparatively more tax liability issues.

Jason Thomas, Ph.D., CFA
Chief Investment Officer

'Tis the Season: Year-end Tax Planning Strategies

As we approach year-end, we work with clients and their tax and legal advisors to identify and execute tax minimization opportunities. Below we briefly describe a number of the opportunities that are available through the end of the year.

Investment portfolio

The volatility in equity markets during 2011 provided a number of opportunities to harvest capital losses in some client portfolios, particularly where money had been invested in the last year. We will continue to look for additional tax loss harvesting opportunities before year-end, although, happily, the strong gains in October have made capital losses scarce. In addition, there are a number of other tax minimization opportunities that may be appropriate for you or your family.

- **Retirement plans for the self-employed.** If you have self-employment earnings - for example, from consulting services or corporate boards – you are eligible to contribute to your own retirement plan. Most of these plans must be established by December 31, so let us know if you have any self-employment earnings that we haven't already discussed.

- **Catch-up 401(k) contributions.** Individuals age 50 and older are eligible to make an additional $5,500 of "catch-up" contributions (on top of the $16,500 standard contribution) to a 401(k) plan. A recent paystub will show your total 2011 contributions, and if it's below $22,000, you'll want to increase contributions through year-end by filing paperwork with your HR department or 401(k) plan administrator.

- **IRA and Roth IRA contributions.** You have until April 15, 2012 to make $5,000 contributions ($6,000 if 50 or older) to IRAs and Roth IRAs. There are income limitations that disqualify many Aspiriant clients from contributing to IRA and Roth IRA accounts, but many clients' children are eligible if they've earned employment income during the year.

- **Roth conversions.** Regardless of your income level, you can convert your traditional IRAs to Roth IRAs. Doing so requires paying income tax on the conversion amount, but future earnings and distributions are entirely tax-free. You can unwind a 2011 conversion anytime before October 15, 2012, giving you a "free look" period. We can help you determine if a Roth conversion makes sense given your unique income, spending and estate planning objectives.

- **Side-stepping capital gain distributions.** Many mutual funds distribute taxable capital gains at year-end. We monitor estimated capital gain and dividend distributions and, if appropriate, will sell a fund to avoid realizing the gain.

Income taxes

With no sweeping tax legislation being debated by Congress this year, most clients have fewer legislative unknowns to complicate year-end planning. As a result, the traditional tools for deferring income into the following year and accelerating deductions into the current year (e.g., property and state income taxes, charitable gifts) will address the needs of most clients. This article introduces a few other strategies that you may not have considered before.

- **Required minimum distributions.** If you are over 70 ½, you are required to take minimum distributions from your retirement accounts by December 31. Aspiriant calculates and distributes the necessary amount during the fourth quarter.

- **Distributing IRA to charity.** Clients over 70 ½ have an opportunity to make charitable gifts up to $100,000 directly from an IRA to a public charity (not a donor advised fund or private foundation). The donation is considered part of your required minimum distribution and, while you aren't able to deduct the charitable gift on your individual income tax return, you aren't required to report the distribution as income either.

- **Increasing income tax withholding to avoid penalties.** Clients who have underpaid their estimated taxes for any of the first three quarters of the year may be subject to underpayment penalties. This is generally more of an issue for clients who derive most of their income from self-employment activities (e.g., consulting, boards), where income taxes are not withheld. Because the IRS treats withheld taxes as having been paid ratably through the year, clients could cure the shortfalls by increasing tax withholding before year-end. In addition to increasing the withholding rate on salary or bonus compensation, clients over age 59 ½ could withhold taxes on distributions from a retirement plan or IRA to meet their withholding target.

- **Purchase qualified small business stock (QSBS) before the end of 2011.** Clients who invest in small, private companies may well have stock that qualifies as QSBS. Clients who sold QSBS during 2011 can defer taxation if certain conditions are met.

- **Non-business energy property credit.** The credit, equal to 10% of the amount paid for qualified energy efficiency improvements, will apply only to qualified energy efficiency improvements installed in the taxpayer's principal residence and placed in service before January 1, 2012.

Wealth transfer planning

For the first time in several years, the estate tax rules are not changing between 2011 and 2012. The current estate tax rules, established in December, 2010, do not expire until the end of 2012 and therefore there are few critical year-end gift and estate tax planning considerations this year. Next year, however, may be a very busy year-end since, absent any new estate tax legislation, all the current favorable rules terminate, including the increase in the lifetime gift tax exemption to $5 million. We'll discuss the implications of this for your personal estate and gift planning throughout 2012.

In the meantime, any person can make gifts of up to $13,000 to anyone each year. This is a "use it or lose it" opportunity, so clients who are likely to have a taxable estate can substantially reduce their future estate tax liability by maximizing their annual exclusion gifts to family, friends or anyone else whom they'd like to benefit. Gifts can be made outright, to a 529 College Savings Plan for children or grandchildren, or to a special type of irrevocable trust.

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To assure compliance with Treasury Department rules governing tax practice, the Treasury Department now requires that all tax advisors attach the following statement to any and all written communication, except to the extent exhaustive steps are taken to satisfy the new guidelines of the regulation. We hereby inform you that any advice contained herein (including in any attachment) (1)
was not written or intended to be used, and cannot be used, by you or any taxpayer for the purpose of avoiding any penalties that may be imposed on you or any taxpayer and (2) may not be used or referred
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