*Independence you can trust*

# Blue Bell
PRIVATE WEALTH MANAGEMENT

## Reminders

Please let us know if you hold any IRA money outside of Schwab so that we may include this into your RMD calculation for 2015.

Talk to your children about the benefits of starting a Roth IRA.

**SAVE NOW!**
Please consider setting up online access to view your accounts online and to receive your statements and trade confirmations electronically.

SPINTECK powered by BBPWM will be collecting used kids/adult bicycles and parts to donate to The Reading Bike Hub through October 24. Contact us for more information.

## Finding Opportunities In Declining Markets

We have just completed one of the worst quarters for the equity markets in quite some time with the Dow Jones Industrial Average declining 7.6% and the S&P500 declining 6.95%.

"It's time in the market, not timing the market," has always been one of my favorite quotes because it succinctly conveys an important characteristic of successful investing. It is an easy blueprint to follow when the market is rising, however when the market retreats, unsuccessful investors tend to ignore this plan. I do not believe these investors realize that they are in fact timing the market. Instead they believe it is better to wait "until things get better." Investors that wait for "things to get better" are ignoring one of Warren Buffet's primary investment strategies which he describes as, "We simply attempt to be fearful when others are greedy and greedy only when others are fearful." While market declines are certainly not a time to exit the market or even "wait and see," they do provide opportunities to reexamine portfolios, as market declines often lead to opportunities. Two opportunities that have become more attractive as the market has declined are Structured Investments and Closed-End Funds.

We have added significant amounts of Structured Investments to our portfolios over the past year, with the primary driver being the 10% buffer versus market declines that these new issue notes provide. These investments provide principal protection for the first 10% decline of the underlying index. Using a laddered portfolio of numerous Structured Investments with buffered protection will reduce portfolio downfalls over time. Remember that one of the negatives of these notes is the cap or the maximum return that can be earned. A benefit of increased market volatility can be seen through the terms of the Structured Investments. The terms of these investments have improved as caps have increased without giving up any protection.

The second area that presents value is the Closed-End Fund (CEF) market. Like Exchange-Traded Funds (ETFs), CEFs have a net asset value (NAV), which is the total value of all securities divided by the shares outstanding. However, unlike the goal of ETFs, which is to trade at or near net asset value, CEFs may trade above their NAVs (at a premium) or below their NAVs (at a discount). We advise our clients to purchase CEFs at discounts to their NAV, or in other words, at a price which is lower than the value of the securities in their portfolio. I am sure you have heard the expression, "Don't throw the baby out with the bath water," which is a perfect idiom for the CEFs in unhealthy markets. There are safeguards in place that are designed to prevent ETFs from trading at outsized discounts when a large number of sellers exit their positions. These safeguards are not present in the CEF space. As a result, CEF discounts tend to grow during declining markets, leading to attractive relative values creating buying opportunities. Within the past month, over 25% of the CEFs that we hold have hit 52 week high discounts. Growing discounts are not good for holders of CEFs as the value of the CEFs will decline faster than the overall market. Remember, this is a negative for investors that must liquidate or become nervous when they see losses in their CEFs and choose to liquidate. While these larger than normal discounts may be disconcerting for even the most seasoned CEF investors they understand that it is most likely a buying opportunity. In some cases they are adding to CEF positions which have been the worst performers. This may be counter intuitive to most investors, but for educated CEF investors it makes perfect sense because they are able to buy these CEFs at better values. Buying CEFs this way doesn't ensure things won't get worse before they get better, take for instance 2009. March 2009 was the best time I have ever seen to purchase CEFs as discounts rose to extreme levels. Investors that purchased CEFs in late 2008 looked silly by February of 2009 as discounts continued to rise and CEFs as an asset class continued to underperform. These early purchasers appeared foolish in the short-term but were handsomely rewarded over the long-term. As markets stabilized and then improved, the discounts narrowed. In other words, these CEFS outperformed because not only did the value of their holdings increase but the discount also narrowed. We certainly cannot say that now is the perfect time to buy CEFs, but what we can say, is that CEF discounts are larger now than where they typically trade and are considered a better value. For a long-term investor that understands CEFs and knows that things may get worse before they get better, purchasing CEFs at larger than normal discounts will prove beneficial over the long-term.

# BBPWM In The News

Blue Bell Private Wealth Management will be featured in the December issue of Philadelphia Magazine as a Five Star Wealth Manager.

# Good Things Come To Those Who Wait

We have invested in Structured Investments through bull, bear and flat markets and continue to recommend them because of their ability to provide both partial downside protection and upside potential.

What is a Structured Investment?

First, it is important to remember that the moniker Structured Investment/Product/Note is just that - a generic moniker used to describe a bank issued note that uses derivatives to create the desired exposure to one or more investments. Essentially they are notes that pay returns based on the stock market meeting certain criteria. Structured Investments vary greatly from note to note, and just because something is considered a Structured Investment does not make it suitable. In fact, we would generally recommend that most investors stay away from many notes as most tend to be overly complex. When we allocate new issue Structured Investments to our clients' accounts, we develop the terms of the notes ourselves. These terms are then bid out in a competitive process whereby we are trying to achieve the best possibly terms under current market conditions.

To understand Structured Investments, let's take a closer look to the terms associated with these investments. **Maturity:** Usually 13 to 18 months, for tax purposes. We typically do not request terms longer than 18 months because the full benefit of the Structured Investment is not realized until maturity. **Underlying Index:** The return of our notes is determined by the performance of an underlying index, which is usually the S&P 500, Russell 2000, or the EuroStoxx 50. **Buffer:** The buffer offers partial downside protection against declines in the market (underlying index). Typically our notes have a 10% buffer. If the underlying index were to fall from the inception of the note until maturity, the notes would not participate in the first 10% of the decline. For declines greater than 10%, the losses would be one to one after the 10% buffer. In other words, if at maturity the underlying index declines by 15% the note would lose 5%. **Upside:** The potential profit of the note is also tied to the return of the underlying index and typically provides a 1.5 or 2 multiplied return of the index. For example, if the note provides a 1.5 multiplied return on the index and the underlying index has gained 5% at maturity the note would pay out a 7.5% return. **Maximum Return:** Thus far everything explained probably sounds too good to be true and it should. One of the negatives to the Structured Investments that we use is that there is a maximum potential profit. For example, if the maximum return is 10%, if the underlying index is up 15% the return on the investment would be limited to 10%. The maximum return is affected by a multitude of factors including interest rates, market volatility and differs from issuer to issuer. While we cannot control the market factors, we can control the issuer, which is one of the reasons that we use different banks to issue these notes. We convey the terms that we are seeking to multiple issuers and then compare the maximum returns to help us choose which bank we pick. The banks also know that we are going to many different issuers and understand that in order to win our business they must provide competitive terms. This is another advantage to using Schwab as our primary custodian as we are free to choose the provider that is best for our clients, not the provider which is best for the bank where the accounts are maintained. Often times Structured Investments offered to investors are created by the bank or brokerage firm where the accounts are held. There is no competition in order to gain the most beneficial terms and the terms of the notes may be complex and quite confusing.

The benefits of Structured Investments may not be fully realized until maturity.

*...continued on page 3*

"Investing is an emotional endeavor. Having an advisor manage your investments helps eliminate a lot of the mistakes investors make when they let emotions affect their investment decisions."

-Christopher Paleologus, *U.S. News & World Report Money,* August 5, 2015, discussing the added benefits that advisors offer over robo-advisors

We hope everything described above is clear. It is most important to remember that the full benefits of the Structured Investments will not be realized until maturity. If the underlying index of a note has declined in value prior to maturity, there is a good chance that the value of the note will also be lower even if the underlying is down significantly less than 10%. Let's take a closer look.

Below are the terms of a note that was issued on April 20, 2015

Original Terms:

Issuer: Bank of Montreal

Issue Price/Par value: $100

Index: S&P500

Buffer: 10%

Upside multiplier: 1.5x

Max return: 13.35%

Maturity: December 26, 201

**Payout Terms at Maturity**

| S&P500 return | -20.0% | -15.0% | -10.0% | -8.6% | -7.5% | -5.0% | -2.5% | 0.0% | 2.5% | 5.0% | 7.5% | 10.0% | 15.0% | 20.0% |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Note return | -10.0% | -5.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 3.75% | 7.5% | 11.25% | 13.35% | 13.35% | 13.35% |

The above exhibit illustrates the original terms of the investment and the subsequent payoff of the note in relation to the S&P 500 return. The red box represents the current return of the S&P 500 (September 30, 2015),which is down 8.6% since inception. If the investment were to mature today, the total gain on the note would be 0% (full return of principal), obviously not a great return, but much better than losing the 8.6% that the S&P 500 declined. Although the investment provides 10% buffered protection against declines of the underlying index, it does not provide that buffer until maturity (December 27, 2016). The note is currently priced at $92.59 or down 7.4% from the initial price. With the S&P500 down 8.6%, the note provides a partial buffer of 1.2% but not the 10% buffer that is promised at maturity. This must be considered when reviewing portfolios. We can now analyze this position based on the current S&P500 level and the current price of the note.

**Payout Terms at Maturity based on current levels (9/30/2015)**

| S&P500 return from (09/30/2015) | -20.0% | -15.0% | -10.0% | -7.5% | -5.0% | -2.5% | 0.0% | 2.5% | 5.0% | 7.5% | 10.0% | 15.0% | 20.0% |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Note return from (9/30/2015) | -10.21% | -5.28% | -0.34% | 2.13% | 4.60% | 7.07% | 8.01% | 8.01% | 8.01% | 8.01% | 8.91% | 16.31% | 22.43% |

The exhibit above illustrates the return of the note from its current price of $92.59 and the current value of the S&P500 1920.03 (September 30, 2015). Remember the S&P has declined by 8.6% since the note was issued, but as long as the note is not down by more than 10% the note will return par value or $100. If the market does not change at all from today, the S&P500 will still be down 8.6% from inception but the note would mature at 100. The 8.01% return illustrated in the yellow box represents the gain from the $92.59 current price and the $100 maturity value.

Remember the full benefits of Structured Investments are realized at maturity and not before. In declining markets, the buffers will prove advantageous however the full benefits will not be reflected until maturity. With Structured Investments, it is a case of, "Good things come to those who wait."

# Charitable Giving: Stock or Cash?

As we approach the end of the year, many investors consider making charitable gifts to their favorite charities. Often, these gifts are made via cash or check. Investors may receive additional tax benefits on their gifts by donating long-term appreciated stock instead.

Comparing the Tax Benefits

When you gift cash or stocks, you may reduce your current income tax liability. Of course, to get this benefit, you have to itemize your deductions on your federal income tax return. The amount you actually save depends on your tax bracket. As an example, in a 35% marginal tax bracket, a $10,000 gift to charity could save you $3,500 in taxes and in a 15% marginal tax bracket, the same gift could save you $1,500 in taxes. However, when you gift long-term appreciated stock to charity, you get an additional tax benefit: you will avoid paying tax on the “built-in” capital gain of the investment.

Examples of Giving Stock vs. Cash

Let’s assume an investor gives $10,000 to a charity, and their marginal tax bracket is 33%.

Example 1 assumes the gift is a $10,000 check.
Example 2 assumes the gift is long-term appreciated stock with a cost basis of $2,000 and a fair market value of $10,000 on the date of the transfer.

| | Income Tax Saved | Capital Gain Tax Avoided | Medicare Tax on Investment Income Avoided |
|---|---|---|---|
| **Example 1** | $10,000 x 33% =**$3,300** | N/A | N/A |
| **Example 2** | $10,000 x 33% =**$3,300** | $8,000 x 15% =**$1,200** | $8,000 x 3.8% =**$304** |

Now let's assume the same gift is made by an individual in a marginal 39.6% tax bracket:

| | Income Tax Saved | Capital Gain Tax Avoided | Medicare Tax on Investment Income Avoided |
|---|---|---|---|
| **Example 1** | $10,000 x 39.6% =**$3,960** | N/A | N/A |
| **Example 2** | $10,000 x 39.6% =**$3,960** | $8,000 x 20% =**$1,600** | $8,000 x 3.8% =**$304** |

These examples show that donating long-term appreciated stock rather than cash may provide an additional tax benefit to the donor. This is only a hypothetical example. Actual tax benefits will vary depending on the details of your overall income tax situation, the type of property donated, and the type of organization that receives your gift.

## BBPWM Team


**Justin Capetola**
Partner
jcapetola@bluebellpwm.com

**Scott Miller Jr.**
Partner
smiller@bluebellpwm.com

**Scott Miller Sr.**
Partner
jsmiller@bluebellpwm.com

**Jon Sobotkin**
Partner
jsobotkin@bluebellpwm.com

**Hank Fox**
Investment Advisor Representative
hfox@bluebellpwm.com

**Christopher Paleologus**
Vice President
cpaleologus@bluebellpwm.com

**Jim Behr**
Investment Advisor Representative
jbehr@bluebellpwm.com

**Derek Finney**
Intern
Denison University

**Follow us on Twitter: @BlueBellPWM**

**Like us on Facebook: Facebook.com/BlueBellPWM**

**Connect with us on LinkedIn: Blue Bell Private Wealth Management**

**Blue Bell Executive Campus**
**Suite 305**
**470 Norristown Road**

**Tel: 610.825.3540**
**Fax: 610.825.9690**
**www.bluebellpwm.com**



PLEASE REMEMBER THAT PAST PERFORMANCE MAY NOT BE INDICITIVE OF FUTURE RESULTS. DIFFERENT TYPES OF INVESTMENTS INVOLVE VARYING DEGREES OF RISK, AND THERE CAN BE NO ASSURANCE THAT THE FUTURE PERFORMANCE OF ANY SPECIFIC INVESTMENT, INVESTMENT STRATEGY, OR PRODUCT MADE REFERENCE TO DIRECTLY OR INDIRECTLY IN THIS NEWSLETTER, WILL BE PROFITABLE, EQUAL AND CORRESPONDING INDICATED HISTORICAL PERFORMANCE LEVEL(S), OR BE SUITABLE FOR YOUR PORTFOLIO. DUE TO VARIOUS FACTORS, INCLUDING CHANGING MARKET CONDITIONS, THE CONTENT MAY NO LONGER BE REFLECTIVE OF CURRENT OPINIONS OR POSITIONS. MOREOVER, YOU SHOULD NOT ASSUME THAT ANY DISCUSSION OR INFORMATION CONTAINED IN THIS NEWLETTER SERVES AS THE RECEIPT OF, OR SUBSTITUTE FOR, PERSONALIZED INVESTMENT ADVICE FROM BLUE BELL PRIVATE WEALTH MANGEMENT LLC. PLEASE REMEMBER TO CONTACT BLUE BELL PRIVATE WEALTH MANAGEMENT LLC IF THERE ARE ANY CHANGES IN YOUR PERSONAL/FINANCIAL SITUATION OR INVESTMENT OBJECTIVES FOR THE PURPOSE OF REVIEWING/EVALUATING/REVISING OUR PREVIOUS RECOMMENDATIONS AND/OR SERVICES. PLEASE ALSO ADVISE US IF YOU WOULD LIKE TO IMPOSE, ADD, OR TO MODIFY ANY REASONABLE RESTRICTIONS TO OUR CURRENT WRITTEN DISCLOSURE STATEMENT DISCUSSING OUR ADVISORY SERVICES AND FEES REMAINS AVAILABLE FOR YOUR REVIEW UPON REQUEST.