APRIL 2016

Advisor

BALTIMORE - WASHINGTON FINANCIAL ADVISORS

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President's Address

MILLENNIALS AND ESTATE PLANNING: HOW TO GET STARTED

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MILLENNIALS STAND TO INHERIT ABOUT $41 TRILLION FROM THEIR BABY BOOMER PARENTS OVER THE NEXT FOUR DECADES, REPRESENTING THE SINGLE LARGEST INTERGENERATIONAL WEALTH TRANSFER IN HISTORY OF THE US.

Many parents wonder whether their millennial children will be able to handle the responsibility of caring for them when they're sick, not to mention handling their hard-earned money when they're gone.

HAVING "THE TALK" WITH YOUR CHILDREN

Unfortunately, millennials and their parents aren't talking about end-of-life care. About half of Americans die without a will or an estate plan in the United States. In order to save your loved ones from avoidable or additional pain with legal hassles, you should take the time to begin your estate planning today. At BWFA we work with families to strike the right balance and help preserve the family unity that is often most important to you as you plan ahead.

It can be difficult to share the intimate details of your personal finances and we see this with everyone who goes through this process, especially if you've always sought to shelter your children from these types of matters. But not talking about end-of-life care and estate planning can leave them in an even worse situation.

After a parent's death we see strife develop between siblings and/or family because they disagree about how to handle the estate in a fair and equitable manner. In addition, if you wait too long you might be unable to make important decisions on your own when they are needed. We know this is not what you want and we will help guide you through this important and sometimes difficult process.

Your own estate plan will have a direct and profound impact on your children's own financial plans. In order to avoid unnecessary surprises and to ensure that your wishes are carried out, your children need to be aware of your plans. This could affect both their future finances as well as the big life choices they have to make now.

The planners at BWFA use various trust vehicles and financial planning strategies for wealth transfer so that you can precisely control the distribution of your assets over time. Trustees who serve as beneficiaries can help to avoid conflict. We know these issues are difficult to discuss, and we'll help to explain the specifics of your plan to your children and how they fit into it.

ESTATE PLANNING 101

As you think about transferring your wealth to your children, it's important to remember that their responsibility for making important decisions might begin as you get older and can't make them for yourself, either because of mental decline or sickness.

As with all things financial, there are a host of documents that should be in place in order to ensure that you've covered all possibilities.

- **Wills:** Your will outlines who will be in charge of your estate at the time of your death. Designating the executor of your will is just the first step.
- **Living trust:** This is the "preferred" method of transferring assets upon your death. A living trust can help your loved ones avoid probate when you pass away. Trusts typically contain personal property and documentation indicating what should happen to these assets once you've died.
- **Durable power of attorney:** This document ensures a person of your choosing has the authority to make decisions regarding your life if you are "incapacitated" or unable to make decisions on your own. This includes financial and legal decisions.
- **Health-care proxy:** Similar to the durable power of attorney, your medical power of attorney has the authority to make medical decisions on your behalf if you are unable to make these decisions yourself.
- **Advanced health-care directive:** This form allows you to list your health-care preferences. It can be used in conjunction with your health-care proxy to ensure that decisions regarding your medical wishes are enacted as closely to your wishes as possible.
- **HIPPA release form:** When dealing with medical issues, another hurdle that can be prevented by preemptive preparation is a HIPPA release form. This form allows those people listed on your advanced health care directive—in addition to your health-care proxy—be allowed to access your health-care information so they can deal with matters on your behalf should you be unable to.
- **Tax documents:** We have all heard of "death and taxes," but how familiar are you with "taxes in death"? That is right—death, while inevitable, does not stop taxes. Even after you have left your physical body, your essence can be taxed. While the majority of taxpayers do not meet the requirements (and therefore do not have to worry about federal estate taxes), it is important to be aware of their existence. The current lifetime exemption for gift and estate taxes is any combined amount up to $5.45 million ($10.9 million for a married couple), but there are some exceptions. Certain types of property could be considered part of your estate by the government, such as life insurance policies, pensions, retirement plan funds, and past sizable gifts. Furthermore, some states have a state estate tax in addition to federal estate taxes.

Source: Rebecca Sheppard, Benzinga

NOW IS THE BEST TIME TO PLAN

If you don't plan now, and the unimaginable becomes reality, your loved ones will face legal obstacles, hurdles, and battles that could have been avoided. By working with BWFA, we can put a plan in place that fulfills your needs and wishes. We work closely with an attorney that specializes in this area so that you can help your loved ones avoid unnecessary costs, financial duress, legal headaches, and additional pain.

Always be prepared for the worst. While I'm not suggesting you adopt a pessimistic view on life, I am encouraging you to make sure you and your loved ones are taken care of. Not only will this provide you a level of comfort and assurance but your family will also be grateful to you for clearly defining your wishes and intentions. It's easy to procrastinate on these matters and some never get around to setting up an estate plan. By using some proven planning methods and a trusted advisor, you can feel safe and secure in the establishment of your plan.

Robert Carpenter

Advisor

Do you know someone

WHO COULD USE GUIDANCE WITH THEIR INVESTMENTS?

MAYBE YOU KNOW SOMEONE WHO IS RETIRED OR NEARING RETIREMENT AND COULD BENEFIT FROM OUR SERVICES?

WE ASK YOU, OUR EXISTING CLIENTS, TO RECOMMEND OUR SERVICES TO FRIENDS OR FAMILY MEMBERS THAT COULD BENEFIT FROM OUR SUPPORT.

BY HELPING US GROW OUR "FAMILY OF CLIENTS," WE GET TO SHARE OUR PASSION WITH MORE PEOPLE JUST LIKE YOU.

PLEASE CONTACT MEGHAN AT MMANAS@BWFA.COM

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Seminar Preview

CAN WE TALK?

Bob Mauterstock's book *Can We Talk?* is a comprehensive, practical guide that leads Baby Boomers through the process of helping their elderly parents get their financial lives in order. BWFA has invited the author to participate in a seminar on April 21st to discuss his book and share his expertise with attendees.

THE BOOK LAYS OUT THE STEPS TO PREPARE AND HOLD A FAMILY MEETING TO OPEN UP THE LINES OF COMMUNICATION.

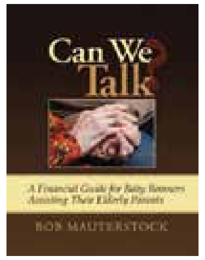
Talking to your aging parents about all the financial issues that affect them is often very risky and difficult to do. *Can We Talk?* gives adult children a practical and empathetic approach for working with their parents to discuss and plan for all the financial decisions they will face. The book lays out the steps to prepare and hold a family meeting to open up the lines of communication. It addresses such critical areas as proper investment strategy, legal issues that can impact the family, creating a plan to deal with the devastating costs of long-term care, and passing on a legacy to the next generation.

Bob calls on his 30 years of experience as a financial advisor to share real-life situations he and his clients have faced and how they developed practical solutions to solve them.

Can We Talk? gives you the tools you need to put your aging parents at ease and give you the peace of mind to know that they are taken care of.

Watch your email for an invitation to BWFA's *Can We Talk?* seminar or call us for additional information and to register.

Bob Mauterstock has achieved the designations of CERTIFIED FINANCIAL PLANNER™ professional and Chartered Financial Consultant. Over the last 30 years, he has specialized in working with elderly parents and their adult children to preserve their legacies and achieve their financial goals. Bob has helped many families create plans to deal with chronic illnesses of family members. He has developed expertise in dealing with Medicaid, Medicare, and veterans' programs to assist families in times of crisis. Bob is Certified in Long-Term Care and has a thorough understanding of long-term care insurance and when it can be used effectively.



THURSDAY, APRIL 21, 2016

6:00 P.M. – 8:00 P.M.

HELD AT SEASONS 52 RESTAURANT LOCATED AT THE MALL IN COLUMBIA

10300 Little Patuxent Parkway, Columbia, MD 21044

Financial Planning

ANNUITIES: GUARANTEED RETURN? TAKE A CLOSER LOOK!

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Planning for retirement can be stressful, especially when you see huge swings in the value of your retirement and investment accounts. It is during these times of volatility that investors are often presented with investment opportunities that may seem too good to be true — and frequently they are.

If you have not been bombarded with sales pitches from investment professionals selling annuities, then you are one of the lucky few. While annuities may have some benefits, they are often not appropriate for investors, and they have several significant drawbacks that should be carefully considered before determining whether annuities are a suitable investment vehicle to accomplish your financial goals.

KNOW THE COST

When purchasing an annuity, you typically make a lump sum payment into an account with an insurance company. The money is invested during a period known as the "accumulation phase." At a later time, you can either receive distributions as an income stream or as a lump sum.

However, the many fees associated with annuities can reduce your investment return. These fees include commissions paid to the broker who sold you the annuity, fees for transferring investments within the annuity, administration and management fees, mortality and expense fees, and surrender charges.

LONG-TERM COMMITMENT

When purchasing an annuity, you should be aware that the investment professional who sells you the annuity is typically paid a large commission by the insurance company, often up to 10% of the cost of the annuity. The insurance company does not want to lose money should you surrender your annuity within the first few years. As a result, insurance companies impose surrender charges if you surrender your annuity, typically, within seven years. For example, an insurance company might impose a 7% penalty if you surrender your annuity in the first year, 6% penalty in the second year, 5% in the third year, and so on. After seven years, you can surrender your annuity without penalty.

KNOW THE RISKS

Just as with any investment, there are no guarantees with annuities. But, if there are no guarantees, then what about the "guaranteed" rates of return on annuities offered by insurance companies? These so-called guaranteed rates of return are misleading. Let us assume you buy an immediate annuity (an annuity that begins to pay you immediately and is not invested) for $500,000, with a guaranteed 6% rate of return. This means that you would receive $30,000 per year for the rest of your life. This sounds great… until you dig a little deeper.

The annuity does not actually have a 6% return. When you purchase an immediate annuity, you are agreeing to give an insurance company a premium ($500,000) in exchange for a guaranteed income stream ($30,000 annually). After you purchase the above annuity, your $500,000 investment is gone — you have paid it to the insurance company. So for the first 16 or so years, the insurance company is only giving you back your own money (your initial premium).

Annuity brokers will often describe annuities as "investments," to discourage investors from thinking about the loss of their premiums. We do not consider an immediate annuity an investment, simply because you do not have access to your initial premium of $500,000.

What about variable annuities? Many of us have heard investment companies, on television and the radio, offering guaranteed rates of return on retirement accounts. They often point to the volatility in the stock market and purport to offer ways to protect your principal. But how is this possible?

These rates of return are only guaranteed for an "income account" or "withdrawal value," they are not the rates of return on your investment. A variable annuity has two accounts. The first account is called the sub account. This is the account in which the premium you paid the insurance company is deposited. It is typically invested in a portfolio of stock and bond mutual funds. The value of the sub account will fluctuate as the underlying mutual funds fluctuate in value, just as in a typical investment account.

The second account is called an "income account," and its initial value typically equals the initial premium paid. However, the income account is the only account that falls under the guaranteed rate of return. The income account will increase in value by the greater of (a) the appreciation of the underlying mutual funds in the sub account, or (b) the guaranteed rate of return. It is important to note, however, that the annuity owner does not have access to the income account and the guaranteed rates of return. He only has access to the sub account. The income account is simply an account value used to calculate your withdrawal amount when you begin receiving income from your annuity.

EXAMPLE

Let us assume you buy a variable annuity for $100,000, and your investment return in the sub account is 4% each year for the next ten years. Let us also assume your annuity offers a guaranteed rated of return of 6%. The sub account would grow to $148,000, based on the 4% return. However, your income account would grow to $179,000, based on the 6% return.

Having the 6% return when the market has only returned 4% sounds pretty good, right? At first glance it does, but you then you read an article about variable annuities. You speak with your financial planner, and you conclude that a variable annuity is not appropriate given your financial goals. When you ask the insurance company to surrender your annuity, you will get the value of the sub account ($148,000), not the "income account" ($179,000). The guaranteed rate of return applies strictly to the "income account" which only comes into play later when the insurance company uses its value to calculate your annual income benefit, if/when you decide to turn on (or annuitize) your income stream.

There are many ways to generate an income stream in retirement. While annuities may be appropriate for some investors, there are usually more cost-effective and efficient investment vehicles available to achieve the same goals. At the risk of sounding cliché, if something sounds too good to be true, it probably is.

Investment Management

TARGET-DATE FUNDS: A GOOD CHOICE FOR RETIREMENT ACCOUNTS?

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Over the years, target-date mutual funds have made their way into many investors' portfolios, particularly 401(k)s and other types of employer-sponsored retirement plans. Perhaps one reason for their popularity is that they seem like relatively easy investments to understand, as they target a clearly defined retirement date (e.g., T. Rowe Price Retirement Fund 2040). In fact, many employer-sponsored plans make these funds a default option if you fail to select a fund on your own.

Because of their apparent simplicity and low cost, target-date funds have become a common way for small investors to save for retirement. However, it is important to consider the pros and cons of target-date funds before relying on them as a part of your retirement portfolio.

PROS OF TARGET-DATE FUNDS

As with most investments, target-date funds are neither all good nor all bad. Instead, there are important aspects to consider that might make them more or less suitable, depending on your investment style and long-term objectives.

Some of the positive aspects of using target-date funds can include:

- **Low expenses.** Some target-date funds carry relatively low expense ratios. The average target-date fund had a 0.78-percent expense ratio in 2014, according to a report by Morningstar, a well-known source of independent research on mutual funds.
- **Asset allocation.** It can be difficult to know how to allocate fund assets on your own. Target-date funds take care of this by selecting an investment blend for the investor of, for example, U.S. and foreign stocks and bonds, as well as cash.
- **Auto-rebalancing.** Components of a portfolio might perform differently over time. That is why it is important to rebalance a portfolio regularly. Target-date funds automatically adjust the blend of assets periodically so that swings in the markets don't throw a participant's allocation off course.
- **Automatic adjustment for changing risk profiles.** The asset allocation of a target-date fund is adjusted to become more conservative over time in order to account for factors that affect an investor's risk profile: a shorter time horizon, fewer chances to make contributions to savings, and greater sensitivity to capital market swings.
- **Little effort.** Target-date funds largely run themselves. For those who want a "set-it-and-forget-it" approach and do not want to be bothered with the details of researching and tracking investments, this might be an acceptable platform.
- **Confidence.** Some investors find it reassuring to have their assets held by investment management companies that are household names. Many target-date funds are managed by large, well-known firms such as T. Rowe Price, Fidelity Investments, and Vanguard.

CONS OF TARGET-DATE FUNDS

For certain investors, the pros of target-date funds make them a reasonable choice for their portfolios. However, there is more to consider when evaluating whether target-date funds are the best investment for your retirement assets.

Some of the negative aspects of holding target-date funds include:

- **Lack of transparency.** Investors are not privy to the underlying securities that are held in a target-date fund. They therefore lack control over where their money is being invested.
- **Layering of fees.** Yes, many target-date funds have low expense ratios. But to get the complete picture, make sure you are looking at the *total* expense ratio, which includes the expenses for the underlying funds and any overlay for packaging the underlying funds together. Many target-date funds include some actively managed funds, which can make their expense ratios high.
- **Not all investors are the same.** Target-date funds assume that all investors at age 65 are in similar positions, which of course is not the case. Individuals who continue to work part-time in retirement or who have bond or cash holdings outside of their retirement accounts likely can tolerate more risk and should hold a higher percentage of stocks. On the other hand, individuals who have little savings and are likely to tap into their retirement funds early might want a higher concentration of bonds.
- **Based on past returns.** Target-date funds take little account of the current market environment and the expected future returns of stocks compared to bonds. This would be acceptable if today's environment and expected returns were similar to the averages in the past, but they are not.
- **Infrequent rebalancing.** Many target-date funds only rebalance every few years at best. Without fairly frequent rebalancing, investors in these funds could find they were hurt by too much equity exposure at the top of the market and with too much fixed-income exposure as the market rebounded.
- **Allocation ranges might vary.** Investors' goals and situations are different, and their portfolios should reflect that. But target-date funds can be hit-or-miss. There are some that would have you in 70 percent equities the year before retirement, while others might have you hold only 30 percent.
- **Lack of flexibility.** Target-date fund allocations are fixed by the fund managers at their corresponding custodians. The investor does not have any control over the underlying funds and cannot adjust the weights during the life of the investment.
- **Wrong date?** Many investors choose a target-date fund without really forecasting the actual date they will start making withdrawals. *Retiring* in 15 years does not always mean that you will be *withdrawing* in 15 years. Your real date of withdrawal could be much later in life, such as when you turn age 70 ½, which is the IRS's required minimum distribution date. Thus, you might need to choose a fund that has a blend that corresponds to commencing withdrawal in a later year.

It makes sense to consult a professional regarding your employer-sponsored retirement account and its available fund line-up before diving into any investment. Today, many investors are paying closer attention to what they are invested in and how those investments are being managed. Many investors want more control over the fund selection in their investment portfolio, to satisfy both their monetary and personal goals.

Please call BWFA if you wish to discuss how to allocate assets held in your employer-sponsored plan.

Investment Management

INVESTMENT PATIENCE IS A VIRTUE

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PATIENCE IS DEFINED AS "THE CAPACITY TO ACCEPT OR TOLERATE DELAY, TROUBLE, OR SUFFERING WITHOUT GETTING ANGRY OR UPSET." EIGHTEENTH CENTURY PHILOSOPHER, JEAN-JACQUES ROUSSEAU ONCE SAID, "PATIENCE IS BITTER, BUT ITS FRUIT IS SWEET."

As is true in many areas in life, investing requires a tremendous amount of patience. Individuals often become increasingly uncomfortable during times of volatility, and inevitably shift their focus from long-term goals to short-term anxiety. A major contributor to this phenomenon is what is referred to as "recency bias." Recency bias is the tendency to believe that trends and patterns of the recent past will continue in the future. *(For more information see http://www.bwfa.com/articles/recency-bias/)* The financial crisis of 2008 epitomized this thought process for many investors. Some of the most educated, long-term investors became increasingly more skeptical as the early days of the 2008 crisis turned into weeks, and the weeks turned into months. These same investors became so susceptible to the fear caused by the market's downward spiral that they lost the patience and discipline needed to stay the course.

Benjamin Graham, the father of value investing, once said, "The investor's chief problem — even his worst enemy — is likely to be himself." As financial advisors, we play many key roles in the lives of our clients, but one of the most important is helping our clients stay focused on the long-term game plan. All of the work we do in terms of research, allocation, diversification, risk management, cash management, etc., is meaningless if investors lose sight of their long-term investment goals.

As an exercise, think back to a time in your life when you were excited to begin a new challenge. You knew this challenge would not be easy, and that it would probably require a significant amount of sacrifice in the short term. Ultimately, however, it would benefit your life over the long term. Maybe your challenge was to start a fitness program, initiate healthier eating habits, or become a better parent. Whatever the challenge, there were probably a few bumps along the way. These sorts of life challenges can be comparable to the challenge of investing for your future. Success is dependent upon a certain level of patience. A tremendous amount of discipline and fortitude may be required along the way, but most of all, success requires patience. Patience is the vehicle that allows discipline and dedication to turn into progress.

Mark Twain said, "I've suffered a great many catastrophes in my life. Most of them never happened." Many investors have a natural tendency to focus so much of their attention on the negative news of the day that it dominates their thoughts. Their short-term focus on negative market reports leads to anxiety, which can then lead to making irrational investment decisions. Heightened investment caution is certainly justified in many situations. We do not advise clients to bury their heads in the sand and ignore their investments.

However to extrapolate the most recent economic events into a future theory can be a mistake. Appropriate risk management requires perspective and balance — especially during times of volatility.

PATIENCE IS THE VEHICLE THAT ALLOWS DISCIPLINE AND DEDICATION TO TURN INTO PROGRESS.

At BWFA we are committed to continuing our disciplined, long-term investment process for each of our clients. We understand that a long-term perspective can easily lose its appeal and put investor patience to the test when times get tough. During times of market turmoil, it often seems justified to take some type of immediate, decisive action — just because. But actions based on haste and prognostication often backfire, leaving investors with bitter regret for their swift, but emotional, responses. We may not be able to entirely control our emotions during tough times, but we should try to consistently heed the wisdom our mothers imparted as we were growing up: Patience is a virtue. Remember... your mother is always right!

Feel free to contact a BWFA professional or make an appointment to stop by our office if you would like to discuss your specific investment strategy and objectives.

LIVE LONG AND PROSPER

JOSEPH MANFREDI
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Living longer is a goal for many people, but living *well* as you age should be equally important. After all, what is the point of living until you are 100 if you cannot enjoy those extra years?

At BWFA we create detailed, customized financial plans to help our clients achieve their long-term financial goals. There are plenty of other services, including a host of "robo-advisors," that calculate clients' goals based on an algorithm and manage investments based on responses to online questionnaires. In contrast, at BWFA we work with each client individually to construct a financial plan based on personal short- and long-term goals. This is at the heart of the service we provide. We hope that our clients can use the advice and guidance we give to realize their ambitions for themselves and for their families.

There are countless resources available that claim to help you live longer, lose weight, get fit, make more money, and improve your life in a multitude of ways. It can be daunting to know which "answer" to turn to, and often it is easier to just maintain the status quo — keep eating the way you always have, maintain the same level of activity, and be satisfied with the job you have. But from this glut of "self-help" information, there are some basic principles that can be distilled and used as an outline to make important changes to your lifestyle that could help you enjoy an increased lifespan.

In *The Blue Zones: 9 Lessons for Living Longer*, Dan Buettner set out to learn the secrets of the world's longest-lived people. **He identified nine principles that these people from far-flung locations around the world have in common:**

1. **Move naturally.** Guess what? The world's longest-lived people are not doing CrossFit. Instead, Buettner says, they move naturally in response to their environments. They grow their food in gardens and do not rely on mechanical aids to accomplish tasks around the house. They walk to work or to visit friends. A Western lifestyle might make it difficult to follow this principle, but it is something to keep in mind the next time you are deciding whether to take the elevator or the stairs.
2. **Purpose.** Why do you get up in the morning? Those who can answer that question, live longer. (Hint: The answer should not be "to go to work.") Research backs up the idea that those who have a sense of purpose in their lives can add up to seven extra years of life expectancy.
3. **Downshift.** Chronic stress leads to inflammation, and inflammation is associated with every major age-related disease. The solution? Find a way to decompress, even for a few minutes a day. Meditate. Take a nap. Take a walk *(see #1).*
4. **Eighty percent rule.** "Clean your plate" is a common mandate in American households. And in recent years, huge restaurant portions make that mantra especially dangerous. Buettner recommends adopting the principle practiced by residents of Okinawa: stop eating when you are 80 percent full. What is more, he says that managing a healthy weight could be easier if you eat your smallest meal in the late afternoon or evening — pretty much the opposite of what most Americans practice.
5. **Plant slant.** Most people who live to 100 eat beans — a lot of beans. Fava, black, soy, and lentil beans are the cornerstones of their diets. When they eat meat (usually pork), it is only about once a week and then only in small portions.
6. **Wine @ 5.** All of the people who Buettner observed and spoke with drink alcohol moderately and regularly. The key, he says, is to drink just one or two glasses a day with friends and/or with food.
7. **Right tribe.** Social circles support healthy behaviors and lead to longer lives. Bad habits, as well as good ones, are contagious. Find a committed group of friends who practice healthy habits, and all of you will live longer.
8. **Community.** Belonging to a faith-based community seems to extend life expectancy. Buettner points to research that shows attending any faith-based service weekly adds 4 to 14 years of life expectancy.
9. **Loved ones first.** Put family first. The longest-lived people keep their aging parents and grandparents close by, which also affects the health of their children. They commit to a life partner and invest in their children.

We hope you will think about ways to increase your quality of life and to add fulfilling years to your life expectancy. Please contact us if you would like BWFA to help you create a solid financial plan to fund those years.

Investment Research

THINKING FAST AND SLOW

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In 2011, Daniel Kahneman, who shared the Nobel Prize in Economic Sciences in 2002, published his best-selling book, *Thinking Fast and Slow*. The book summarizes the decades of research he performed, often in collaboration with Amos Tversky. The broad theme of his research is that human beings are intuitive thinkers and that human intuition is imperfect, with the result being that judgments and choices often deviate substantially from the prediction of normative statistical and economic models. The broad field of behavioral economics might not have even existed without the fundamental work that Kahneman and Tversky performed.

The book focuses on our two systems of thought — "System 1" is fast, intuitive and emotional; "System 2" is slower, more deliberate and more logical — which are used to process information. If you are a fan of the original Star Trek series, Captain Kirk might be thought of as the System 1 thinker. Mr. Spock was most definitely all about System 2.

While Kahneman's academic training was in psychology, he is effectively what we call a Behavioral Economist. A large part of his work focuses on the decisions investors make by trying to sort out problems by using System 1 rather than putting in greater effort and letting System 2 do the work. Kahneman discusses in a fairly detailed manner the numerous cognitive errors that investors can make.

Among the many conclusions reached by Kahneman is that the human mind simply cannot function well in the world without both System 1 and System 2. While we do not need System 2 to know that we should get off the train tracks when a train is approaching, we have to be careful about relying too much on System 1. Otherwise, our snap judgments could be the only judgments we make on a particular subject. In the world of investing, this laziness can ultimately result in financially destructive behavior.

Take a look at the following three questions:

1. *A bat and a ball cost $1.10 in total. The bat costs a dollar more than the ball. How much does the ball cost?*
2. *If it takes 5 machines 5 minutes to make 5 widgets, how long would it take 100 machines to make 100 widgets?*
3. *In a lake, there is a patch of lily pads. Every day, the patch doubles in size. If it takes 48 days for the patch to cover the entire lake, how long would it take for the patch to cover half of the lake?*

If you use only System 1, you will most likely get all three answers wrong. If you use System 2, your chances of getting them right will increase. *(The answers are at the end of this article.)*

For investors, the true power of this book results from the combination of Kahneman's thoughts on (1) how we frequently self-sabotage our results due to our erroneous biases or prejudices, (2) how we incorrectly use examples to form broad conclusions on entire groups (or "populations") and (3) how we can dramatically improve our ability to make correct predictions by using what is called a group's "base rate."

While this may sound quite complex, Kahneman truly does a great job of identifying and explaining the major mistakes in human judgment. If investors understand these pitfalls, they can include elements in their investment process that can potentially minimize the chances of being impacted by them. In short, being able to understand cognitive biases can lead to better buy, sell, or hold decisions.

MAKING BETTER DECISIONS

Oftentimes, we find ourselves torn between emotion and logic in our personal lives as well as when we are making investment-related decisions. Even though we may think the majority of our decisions are based on logic, it is surprising to learn how many are actually influenced by emotion. To complicate matters even more, we also know that people decide differently under pressure or if high risks are involved — exactly the kind of scenario experienced by investors. Kahneman further explains these ideas in his discussion of Prospect Theory (the basis for his Nobel Prize), which highlights how the fear of loss or the temptation for high returns skews our rational mind. We find that investors expend too much energy trying to avoid making hard choices by looking for an informational advantage that will guarantee them a "sure thing." Instead, investors should simply focus on making better decisions.

In other words, we can probably improve our results by making better decisions with available information, rather than trying to find better information. Understanding the psychological behavioral components of investing can help us improve our decision making as well.

HOW RELYING ON SYSTEM 1 CAN FAIL US

Kahneman does not suggest that we are incapable of System 2 thought or that we always follow our intuition. System 2 engages when circumstances require it. Instead, many of our actual choices in life, including some important and consequential ones, are subject to substantial deviations from the standard statistical model. While System 1 can lead to brilliant inspiration, it can also cause systematic errors.

For example, consider one of Kahneman and Tversky's best known questions/experiments:

> *An individual has been described by a neighbor as follows: "Steve is very shy and withdrawn, invariably helpful but with very little interest in the world of reality. A meek and tidy soul, he has a need for order and structure, and a passion for detail." Is Steve more likely to be a librarian or a farmer?*

If you reply quickly to this question, you are apt to say that Steve is more likely to be a librarian than a farmer. The description of Steve is meant to lead you to this conclusion. He certainly sounds more librarian-like. However, there are five times as many farmers as librarians in the U.S. Further, the ratio of male farmers to male librarians is even higher. These latter facts are called base rates. They do not ordinarily come to mind, preventing an accurate computation and answer – Steve is more likely to be a farmer. For most of us (including this writer on first reading), System 2 does not engage.

LOSS AVERSION

For many investors, it is often much more difficult to sell a stock at a loss than at a gain. Kahneman found that individuals are risk averse in the domain of gains, and risk loving in the domain of losses. This point of view is supported by experiments in which individuals choose a gamble with a 50% chance of losing $1,000 over a certainty of losing $500. He sees this concept (loss aversion) as the most important contribution of Prospect Theory to behavioral economics. It is further seen in a basic experiment in which people refuse to take bets that give them a 60% chance of winning and a 40% chance of losing a dollar, even though such a refusal implies an implausibly high level of risk aversion. Kahneman justifies this assumption by noting that biologically our brains might process losses in the same way as threats.

In addition, Prospect Theory argues that the value people place on a change in probability (e.g. of winning something) depends on the reference point: people place greater value on a change from 0% to 10% (going from impossibility to possibility) than from 40% to 50%, and place the greatest value of all on a change from 90% to 100% (going from possibility to certainty).

A WAY TO ENGAGE SYSTEM 2

If you are concerned that your brain does not engage System 2 enough, Kahneman suggests that frowning can activate the skeptic within us, or System 2. Putting on a frown, experiments show, works to reduce overconfidence; it causes us to be more analytical, more vigilant in our thinking, to question stories that we would otherwise unreflectively accept as true because they are simple and coherent.

UPCOMING SEMINAR

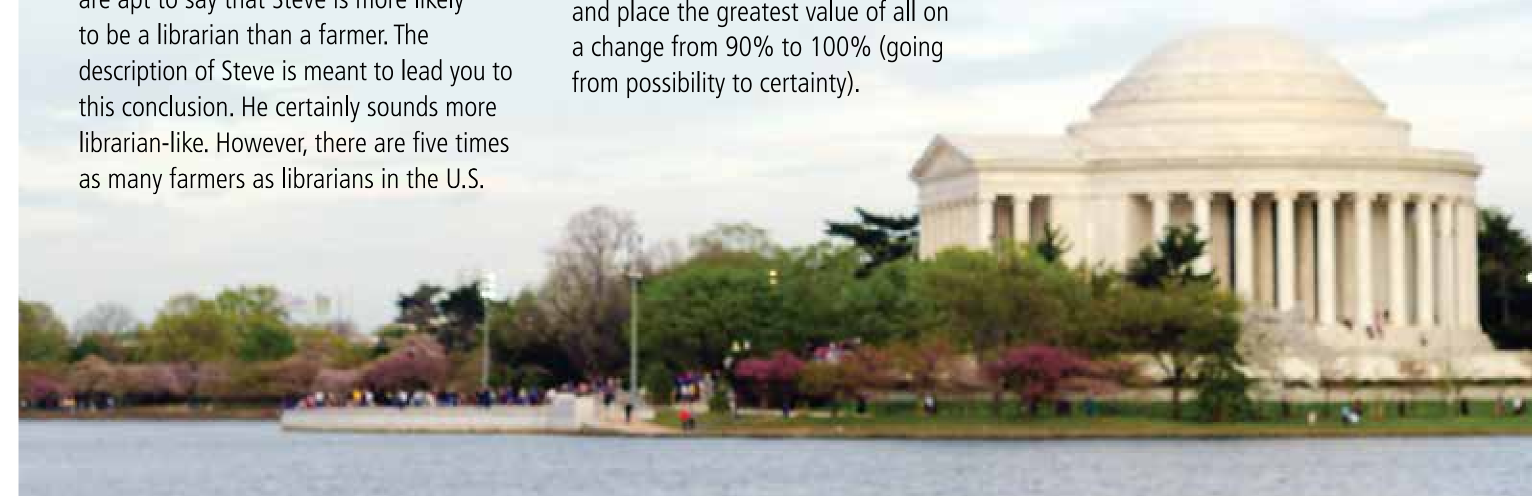
While we do not profess that we can always avoid all the behavioral biases discussed in *Thinking Fast and Slow*, we do our best to put processes in place to help avoid the potential impact of these errors. On the evening of May 19th, we will be hosting a seminar to discuss Kahneman's book in more detail. We hope those of you who are interested in learning more about why people behave the way they do will join us.

QUIZ ANSWERS:

1) *The ball costs $0.05 and the bat costs $1.05. Don't feel bad if you missed this one. More than 50% of students at Harvard, Princeton, and the Massachusetts Institute of Technology routinely provide the incorrect answer.*

2) *Five minutes.*

3) *Forty-seven days.*



Business Services

PREPARING FOR THE DUE DILIGENCE PROCESS

BRIAN MACMILLAN
MANAGING DIRECTOR
MERGERS & ACQUISITIONS
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When selling a business, the due diligence process can be long and tedious. In some cases, the amount of time involved and the amount of information requested by a buyer and its advisors can cause a business owner enough stress that it causes the deal to fall apart. However, there are ways to minimize the time involved in the due diligence process. Understanding the types of questions that will be asked of a business owner and the information the buyer will request is crucial. This will allow business owners to prepare for the due diligence process long before they get to this stage in the sale of their business.

The due diligence process begins after the signing of the Letter of Intent between the buyer and the seller. At this point, the buyer has seen financial statements and has a solid understanding of the business and its customers. Buyers work with banks or other financing entities (i.e. private equity firms) in order to obtain the capital to make the acquisition, and those third parties become more involved at this stage. Due diligence will provide the buyer and its advisors with enough information to provide the level of comfort required for them to complete the transaction. It typically takes 30 – 60 days from the time the Letter of Intent is signed until the due diligence is completed.

Buyers should submit to the seller a Due Diligence Checklist — a comprehensive list of information they want to review during the due diligence process.

There may be some additional requests from the buyer, based on information provided. By having the majority of the requested information readily available, the seller can speed up the due diligence process and give the buyer added comfort in knowing that the seller is organized. Full disclosure during this process is paramount as well.

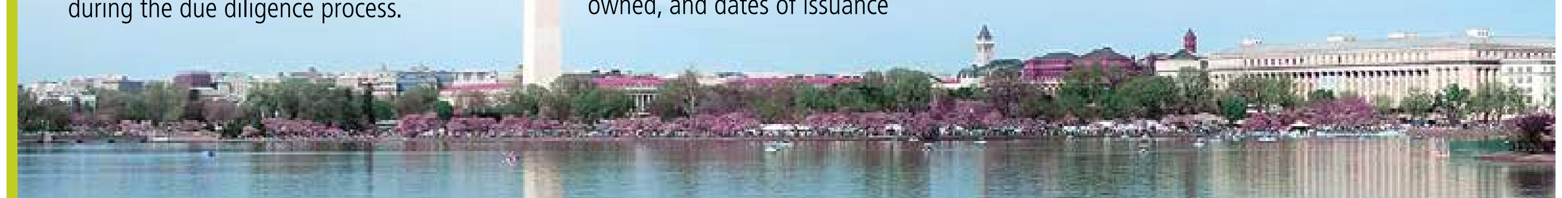
Depending on the size of the selling business, the length of the due diligence request list may vary. Below, are several of the main categories by which the Due Diligence Checklist can be sorted and some of the most commonly requested information within each category.

GENERAL CORPORATE DOCUMENTS

- Certificates or Articles of Incorporation, as well as any Bylaws and amendments
- Minutes of all meetings and written consents of the board of directors and stockholders
- List of all states and foreign countries where property is owned or leased and where business activity is conducted

OWNER/STOCKHOLDER INFORMATION

- The company's stock books
- List of all current stockholders, including their addresses, number of shares owned, and dates of issuance



FINANCIAL INFORMATION

- Financial Statements (audited, reviewed, or compiled depending on the size of the company) for at least three years
- The most recent internal financial statements and comparable statements for the same time period during the prior year
- Projections and budgets
- Asset lists, including description of depreciation and amortization methods
- Schedule of inventory
- Schedule of all debt and other contingent liabilities
- Schedule of accounts receivable and accounts payable

TAXES

- Copies of federal, state, and local income tax returns for at least the last three years
- Any IRS audit reports
- Any tax liens

ASSETS

- Schedule of fixed assets and their locations
- U.C.C. filings, equipment leases, schedule of sales and purchases of major capital equipment

INTELLECTUAL PROPERTY

- Schedule of copyrights, trademarks, and trade names
- Schedule of patents and patent applications
- Schedule of any claims (actual or threatened) regarding the intellectual property

PRODUCTS OR SERVICES

- List and detailed descriptions of all products or services sold or offered by the company

CUSTOMERS

- Schedule of all of the company's customers
- Any customer agreements or service agreements
- Summary of revenue by customer, detailing any customer concentration issues

REAL ESTATE

- Copies of all leases, deeds, mortgages, titles, surveys, zoning approvals, variances or use permits
- Any environmental audits

MATERIAL CONTRACTS

- Copies of all contracts between the company and any officers, directors, or affiliates
- All loan agreements/arrangements or other promissory notes
- All indentures, collateral pledges, and guaranties
- Distribution agreements
- Sales representative agreements
- Any non-disclosure or non-compete agreements
- Marketing agreements
- Agreements with suppliers
- Copies of standard quotes, purchase orders, invoices, and warranty forms
- Copies of any governmental licenses, permits or consents

INSURANCE COVERAGE

- Schedule of the company's insurance claims history for at least the past three years
- Copies of all of the company's insurance policies, including general liability, worker's compensation, property, product liability, errors and omissions, and any and other insurance

EMPLOYEES AND EMPLOYEE BENEFITS (HUMAN RESOURCES)

- All employment and consulting agreements
- List of employees, including date of hire, positions, salaries, and bonuses
- Copy of the personnel handbook
- Schedule of all employee benefits and holiday, vacation, and sick leave policies
- Descriptions of any retirement plans
- A list of any alleged wrongful termination, harassment, or discrimination cases
- Worker's compensation and unemployment insurance claims history

SERVICE PROVIDERS

- List of any professional service firms used by the company, including accounting firms, law firms, and consulting firms

ENVIRONMENTAL ISSUES

- List of environmental permits and licenses
- Copies of any notices from federal, state, or local regulatory agencies
- List of any hazardous substances used in the company's operations

LEGAL ISSUES

- List of any pending or threatened litigation
- Copies of any documents related to any prior settlements

This list is not comprehensive, and all companies will have information requests specific to their particular industries. However, any business owner can look at the list above and understand how time consuming it may be to gather all of this information. Planning ahead and having this information compiled prior to the signing of the Letter of Intent will save time and could ultimately save the deal. If you own a business and are interested in reviewing a sample Due Diligence Checklist, please contact the Mergers & Acquisitions team at BWFA.

Tax Services

TOP 10 TAX STRATEGIES

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Filing your tax return is a once-a-year event, but there are things you can do throughout the year to help reduce your tax burden and protect your assets.

BOOST YOUR RETIREMENT SAVINGS

One of the best ways to lower your tax bill is to reduce your taxable income. You can contribute up to $18,000 to your 401(k) or similar retirement savings plan in 2016, plus a catch-up contribution of $6,000 if you are 50 or older by the end of the year. Any money contributed to the plan is not included in your taxable income.

Whether or not you have a retirement plan at work, you can contribute up to $5,500 to an IRA plus an additional $1,000 if you are 50 or older. Depending on your income and whether you participate in a retirement savings plan at work, you may be able to deduct some or all of your IRA contribution. Or you can choose to forgo the upfront tax break, again depending on your income, and contribute to a Roth IRA that will allow you to take tax-free withdrawals in retirement.

TAKE ADVANTAGE OF EMPLOYER BENEFITS

If your employer offers a medical reimbursement account, or flexible spending account, consider contributing to this plan to help save tax dollars. These plans let you divert part of your salary to an account from which you can then pay medical bills. You avoid both income and social security tax on the money; this can save you 20% to 35% or more compared with spending after-tax money. A word of caution, though — this is a "use or lose" deal. You must use all funds in a medical reimbursement account before the end of the tax year (or for an additional time period that your company's plan allows), or the funds will be forfeited. The maximum you can contribute to a health care flex plan in 2016 is $2,550.

Employees can exclude up to $5,000 of employer-provided dependent care assistance from their gross income. The excludable amount is not subject to income, social security or Medicare tax.

CHARITABLE GIVING

If you plan on making a significant gift to charity, instead of cash, consider giving appreciated stocks or mutual fund shares that you have owned for more than one year. Doing so supercharges the saving power of your generosity. Your charitable contribution deduction is the fair market value of the securities on the date of the gift (not the amount paid for the asset) and you never have to pay tax on the capital gain/profit. However, do not donate stocks or fund shares that lost money. You would be better off selling the asset, claiming the loss on your taxes, and donating cash to the charity.

Keep track of what you spend while doing charitable work – from what you spend on stamps for a fundraiser, to the cost of ingredients for casseroles you make for the homeless, to the number of miles you drive your car for charity (at 14 cents a mile). Also, clean out your closets on a regular basis to donate items you no longer use and reap the tax benefits. Add such costs with your cash contributions when figuring your charitable contribution deduction.

IDENTITY THEFT

There are millions of people each year who have their identities stolen. There are ways to help minimize this possibility. Be sure to choose strong passwords and PINs. Also, beware of phishing scams, take care when shopping online, shred important documents, and check your credit reports on a regular basis.

BUSINESS OWNERS

Choose the best form for your business: a sole proprietorship, a subchapter S corporation, a C corporation or a limited-liability company (LLC). Your choice will have an impact on your taxes.

If you own your own business, keep accurate and complete records. There are some inexpensive computer programs that handle basic record keeping for a small business and can really help come tax time. Be sure to keep your business expenses separate from your personal expenses.

Consider taking a home office deduction, if you use part of your home regularly and exclusively for your business. If you have a home office, you can qualify to deduct some costs that are otherwise considered personal expenses.

IRS TAX NOTICES

If you receive a tax notice from the IRS, do not assume that it is correct. Most IRS notices are computer-generated and have not been reviewed by a human before they are sent to you.

You have the right to dispute the notice. You should respond in a timely manner with supporting documentation and use certified mail so you have proof that your response was received.

If you do receive a notice that is correct and you owe the tax, you may need to amend your state tax return, as you may also owe additional state income tax.

EMPLOYEES

If you got a big tax refund or owed a lot of tax when you filed your tax return, consider adjusting your withholding. Filing a new W-4 form with your employer allows you to fine-tune the amount withheld so it more closely approximates the amount of tax you expect to owe.

Remember to keep track of your job-hunting costs. As long as you are looking for a new position in the same line of work, you may deduct job-hunting costs. If your search takes you away from home overnight, you may deduct travel expenses such as the cost of food, lodging, and transportation. These costs may be deductible to the extent they exceed 2% of your adjusted gross income.

GO GREEN

A tax credit is available to homeowners who install alternative energy equipment. The credit equals 30 percent of what a homeowner spends on qualifying property, including labor costs, for items such as solar electric systems, solar hot water heaters, geothermal heat pumps, and wind turbines. There is no cap on this tax credit, which is available through 2016.

AFFORDABLE CARE ACT

Have health insurance or be prepared to pay the price at tax-filing time. The price keeps going up. The individual responsibility payment penalty for not having minimal essential medical coverage is based each month on the number of uninsured members of your family and your household income. An uninsured household of 3 or more during the 2015 tax year could face a maximum penalty of $975. The maximum penalty for the 2016 tax year skyrockets to $2,085.

FOREIGN BANK ACCOUNTS

Report all income received from foreign financial accounts. Additional disclosure may be required if you have an interest in or authority over a financial account located outside the U.S. and the aggregate value of all foreign accounts is $10,000 or more. The penalties for failing to file the appropriate forms can be substantial.

For more tips on how to minimize your tax burden and keep your hard-earned money in your pocket, consider attending one of BWFA's seminars, such as one scheduled in May: Start Planning Now for Next Year's Tax Return. Watch your email for an invitation or call us for additional information and to register.

What's Happening at BWFA

RUNNING A PAPERLESS OFFICE

MEGHAN MANAS
DIRECTOR, CLIENT SERVICES
mmanas@bwfa.com

ONE OF BWFA'S GOALS IN 2016 IS TO MOVE TOWARD BECOMING A MORE PAPERLESS OFFICE. HERE ARE A FEW OF THE BENEFITS THAT ARE MOTIVATING OUR MOVE TO A MORE PAPERLESS ENVIRONMENT:

EASY ACCESS: All documents that come into our office will be scanned and stored in digital form. This will alleviate the need to pass papers among our staff and then file documents in physical file cabinets. Our staff can easily retrieve and share your electronic documents with colleagues who require them to serve your needs.

IMPROVED CUSTOMER SERVICE: Having electronic access to files means less time tracking down and searching through paper documents. Searches can be easily done and should yield results quickly. This could result in, for example, less time "on hold" for clients who phone us.

DISASTER RECOVERY: Encrypted copies of all BWFA's files, including all electronic documents, are routinely backed up and saved both locally and securely offsite, keeping documents safe from disasters such as fire or water damage.

ENVIRONMENTAL BENEFIT: Even a small paperless office can save hundreds of reams of paper each year. In some small measure, this will preserve resources and spare trees growing our Nation's forests, so they can benefit future generations.

If you are a BWFA Tax client, you will have begun to see the results of some of our efforts this tax season. The tax team began sending our clients copies of their 2015 tax returns and e-file forms via DocuSign, an electronic signature technology. DocuSign has made it easy for our clients to quickly and securely provide electronic signatures needed for filing their tax returns. This practice is helping us keep costs down and submit returns in a timely manner.

For our BWFA Investment Management clients, we have begun using DocuSign in partnership with TD Ameritrade, again allowing us to quickly and securely capture electronic signatures and important customer information for account openings, money movement, beneficiary changes, and a variety of other activities. Electronically signed documents are directly submitted to TD Ameritrade for prompt processing.

We hope to take our paperless efforts even further this year by beginning to make available to our clients electronic versions of our quarterly statements. We have been researching solutions that would provide our clients with a secure, convenient, and environmentally friendly way to access their quarterly statements. We hope to have the right plan in place before the end of the year. Be on the lookout for an email with more information, once this service becomes available.

Upcoming Events

APRIL 7, 2016
6:00 P.M. – 7:30 P.M.
Selecting Your State of Residence in Retirement

APRIL 12, 2016
6:00 P.M. – 7:30 P.M
What are the Pitfalls of Annuities?

APRIL 14, 2016
6:00 P.M. – 7:30 P.M.
What You Need to Know About Retirement Before You Retire

APRIL 21, 2016
6:00 P.M. – 7:30 P.M
Can we Talk? A Financial Guide for Baby Boomers
Guest Speaker – Bobby Mauterstock
Held at Seasons 52 – Columbia

APRIL 28, 2016
11:30 A.M. – 1:00 P.M.
Protecting Yourself Against Identity Theft
Guest Speakers from the FBI and Howard Tech Advisors

MAY 3, 2016
11:30 A.M. – 1:00 P.M.
How to Be a Trustee
Guest Speaker from Elville and Associates

MAY 24, 2016
TIME TBD
Charitable Giving and Philanthropy
Guest Speaker: Dean Bouland, Bouland & Brush
Guest Speaker: Beverly White Seals, Community Foundation of Howard County

B | W | F | A

Baltimore-Washington

FINANCIAL ADVISORS

RETIREMENT & ESTATE PLANNING | INVESTMENT MANAGEMENT | TAX SERVICES | BUSINESS SERVICES

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