



SPRING 2010



trust & investment *perspectives*

Deficits Do Matter **by Willard N. Woolbert**



In October 2009 the Greek government announced that their budget deficit would reach 12.7% of gross domestic product. This level is more than four times the European Union (EU) limit. This shocked credit and currency markets and led to a dramatic rise in the cost of borrowing for Greece. As the details unfolded, concern spread beyond Greece to what have become known as the PIIGS (Portugal, Italy, Ireland, Greece and Spain), countries with some of the same issues as Greece. In response, the EU and the markets have demanded dramatic cuts in the Greek budget, including higher taxes and reductions in public employee wages, in order to try to reduce the deficit and consequent funding needs. As a way to reduce the funding costs of the debt Greece needs to issue, as well as provide support for the government's actions, a debate has raged within the EU as to whether to provide support and, if so, how. Direct subsidies, debt guarantees, and International Monetary Fund (IMF) intervention have been offered as potential means to quiet the storm. Political divisions within the EU limit what the European Central Bank (ECB) can do, and concern that too generous an outcome

for Greece would discourage other PIIGS from the difficult fiscal decisions that must accompany relief, have made this a prolonged and messy process.

Complicating all of this is Greek membership in the EU with its common currency and monetary policy. Draconian cuts in the Greek deficit will depress growth. Devaluation of the currency would allow Greek industries to be more competitive and thus to import some growth. Without that capability, one of two things needs to occur. Either Greece needs to find a way to become more competitive within the EU, or the ECB must recognize the problems of the PIIGS and find a way to devalue the Euro. The

former is at best a long-term solution requiring improvement in productivity and prolonged economic weakness. The latter would create problems for more prosperous EU countries such as Germany. Thus the difficulty in finding a solution to the problem and the likelihood that support for Greece and possibly the other members of the PIIGS, will be an ongoing issue.

As difficult as the problems facing Greece are, they represent, after all, only a bit more than 2% of the EU's output. U.S. banks have very little exposure to the debt. Why should this impact our investment decisions? We see two issues that have influenced our asset allocation decisions.

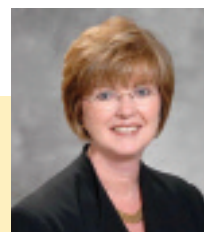
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Pennsylvania Trust Welcomes New Board Members

Eileen McDonnell, newly named President of Penn Mutual Life Insurance Company, becomes a member of the Pennsylvania Trust board at the upcoming May meeting. McDonnell, formerly Chief Marketing Officer for Penn Mutual, is now responsible for the company's day-to-day operations and will also serve on their Board of Trustees.

Also joining the Pennsylvania Trust board is David Penn, Executive Vice-President and Director of Wealth Management at Janney Montgomery Scott, where he is responsible for oversight and execution of the Investment Advisory, Financial Planning, Insurance, Annuity, and Cash Management services.

They both bring expertise and experience in the financial services industry that will accrue to the benefit of Pennsylvania Trust and our clients.



President's Message: Recent Reflections: Local and Abroad



I recently returned from a journey to Egypt and while I quickly found myself immersed in my daily responsibilities, I can't help but pause from time to time to reflect on my experience there. Unsure of how, as an American, I would be welcomed to this politically tumultuous part of the world, I was delighted by the warmth and hospitality that greeted me. I met people who were anxious to show me the wonders of their country and share the experiences of daily life in this crowded, ancient place, which is indeed steeped in history yet embracing the 21st century where economies rise and fall along with world markets.

If nothing else, these travels remind me that the world is one of contrasts, large and diverse, yet at the same time, through sophisticated technology, small and interconnected. For quite some time now, economic conversation has reflected a worldview and we closely follow markets around the globe, taking advantage of opportunities to expand our investment options for client portfolios. Our Chief Investment Officer, Bill Woolbert's article in this issue reviews the international market with a particular note on Greece and its recent credit crisis.

Overall, the world economy con-

tinues to see a gradual recovery with economists forecasting expansion, albeit modest, for the year. Closer to home the outlook is also hopeful and much improved from the picture we were seeing last spring. The markets have been showing a constructive trend and consumers are demonstrating a renewed interest in spending. Home sales are seeing some gains and the corporate sector boasts a cash flow surplus that should boost spending and productivity. However optimistic, we do keep a watchful eye on the growing U.S. deficit, unemployment, and the monetary policies that could result from the Government's efforts to manage debt. Growing partisanship in Congress is disappointing and will no doubt affect how the future is shaped.

The repeal of the Federal Estate Tax and Generation Skipping Transfer Tax is on the mind of many and, in this issue, Irwin Love, our Chief Fiduciary Officer, provides some clarity and cautions on this complicated turn of events. Tax matters have become increasingly complex and to better address our clients' requirements, the expanded capabilities of our Tax practice is working to improve upon our current high level of thoughtful solutions. The recent additions to our Tax

Administration team, Jeanne Stagloff and Diane Ferrie, bring a wealth of knowledge in tax planning and preparation.

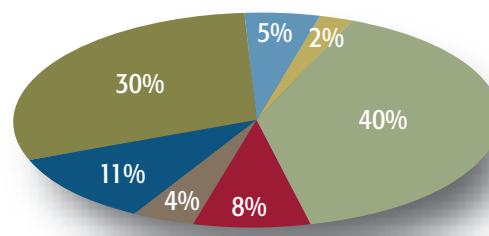
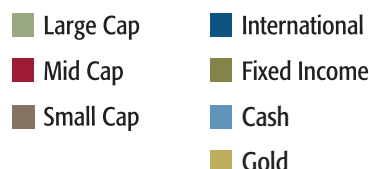
The thoughtful expansion of this service, like others, has grown out of what we were hearing from our clients as well as our strategic intentions to increase capacity in wealth management. My previous letter mentioned the efforts expended in developing a strategic plan for the years ahead and I will continue to update you as we make progress toward our goals.

As you know, a large part of a successful relationship comes from listening to client concerns and objectives and taking the time to develop a sincere rapport. We appreciate the continued loyalty of our clients and take pride in the consistent growth and success that Pennsylvania Trust has earned by that loyalty.

I am glad to be home and resume my routine, even though I must say that I had no trouble using an iPhone to check the markets and email during my travels. I return with my perspective refreshed, grateful for time spent exploring the rich and varied vastness of the world.

Richardson T. Merriman
President and Chief Executive Officer

Balanced Asset Allocation



TRUST TALK

Absence of Estate Tax Legislation: Concerns and Considerations

by Irwin S. Love, Esq.



Against all odds, if one had wagered in 2009 that there would be neither a federal estate tax nor a generation skipping transfer tax (GST) in 2010, there would have been few takers. But since Congress has not legislated the continuation of either, these taxes that existed in 2009 with exemptions of \$3.5 million and tax rates of 45% are now history for 2010 only.

Unless Congress passes legislation to reinstitute the federal estate tax, the estate of a decedent dying in 2010, while not being subject to federal estate tax, will instead be encumbered by what is known as "carryover basis." This means, for most purposes, that the institution known as "step up" (to date of death value) is no longer the law, and instead the decedent's historical cost remains the tax basis upon the sale of assets after death. An exception would be a date of death value that is less than historical cost, in which case the date of death value will be treated as cost.

Under this carryover basis, the executor can allocate up to \$1.3 million of gain to be added to the historical cost of selected assets. If there is a surviving spouse, an additional \$3 million of gain can be allocated to assets left to the surviving spouse or in a qualified trust for the spouse's benefit.

This will not be an easy regime for

the executor to administer. How will the executor choose assets to be allocated in the event he or she is also a beneficiary? What protection from legal liability will be afforded the executor in making the choice of assets? While recent legislation requires the brokerage industry to provide accurate cost information, this may be an impossible task for the executor where a decedent has kept poor records or left no records at all. Also note that all assets formerly taxable for federal estate tax purposes will not necessarily be eligible assets for purposes of the \$1.3 million and \$3 million gain allocations.

The elimination of the federal estate tax and GST in 2010 dates to legislation in 2001. Under that legislation, while there is no tax for 2010, beginning January 1, 2011, the taxes are reinstated but at exemptions and rates in existence before 2001. The federal estate tax exemption will be \$1 million with a tax as high as 55%. The exemption for GST purposes, because it is adjusted for inflation, will be \$1.34 million as things stand now. Here, too, the highest rate will be 55%.

Financial advisors are wrestling with how to counsel their clients. Careful and informed consideration is paramount. Under the law as it presently exists for 2010, certain formula clauses may give rise to distribution outcomes that were not

intended, possibly leading to unwanted, if not detrimental outcomes. (A number of states have passed legislation intended to circumvent these outcomes, but to date Pennsylvania has not.) On the other hand, the gift tax rate has now been reduced to 35% for 2010. Wealthy individuals willing to take risks that there will be no retroactive legislation might consider making taxable gifts at this reduced rate. Others may wish to make generation skipping transfers to grandchildren or great grandchildren.

One wonders what the future holds. Will Congress pass legislation during 2010 impacting the current state of affairs? Will Congress attempt to make any legislation retroactive to January 1, 2010 and impose federal estate tax and GST for all of 2010? The most reasonable outcome, if a retroactive bill is passed, might well be a choice for an estate to use the retroactive legislation or the law in effect at the time of the death or gift. But many believe any retroactive legislation would be unlawful on constitutional grounds.

Predicting what Congress will do has no better odds than the 2009 predictions that they would not allow the federal estate tax and GST to be repealed in the first place. A busy Congressional calendar and sensitivities toward midterm elections will certainly factor into the ultimate outcome.

As always, Pennsylvania Trust's administrative officers stand ready to address your questions and to discuss how these federal tax issues might affect you and your individual estate goals.

Mr. Love is Senior Vice President and Chief Fiduciary Officer at Pennsylvania Trust.

Pennsylvania Trust Walkers Support MS



An enthusiastic team of 28 Pennsylvania Trust staff, family, and friends participated in WALK MS 2010, a two-mile trek through Norristown's Elmwood Park Zoo, benefiting the National Multiple Sclerosis Society. This annual Delaware Valley event boasts thousands of walkers in seventeen locations. Kristen Behrens and Kim Patterson served as co-captains of this spring Community Service effort.

continued from page 1 For many years international diversification of portfolios has meant a healthy weighting in the developed markets (EAFE) and perhaps some exposure to the developing or emerging markets. Our view has been the reverse, with a larger commitment to the developing markets. This approach has been based on the desire to invest in the higher growth markets, ones with improving financial characteristics and the potential for some currency appreciation against the U.S. dollar. The problems in Greece highlight for us the dramatic differences between the "old" world markets and the "new". In contrast to China and India who are beginning to tighten in order to slow growth, Europe is struggling to generate growth. Brazil's currency appreciated so rapidly in the fourth quarter of 2009 that they imposed a tax on cap-

ital inflows. In response to the difficulty in solving the debt crisis in Greece, the Euro has fallen approximately 10% to 1.33 to the dollar. This has a direct impact on the return to U.S. investors and we think it could fall further. The excitement of the developing markets is not undiscovered. Emerging market stocks have been the best performing asset class six of the past seven years. Currently, with fiscal and monetary policy in many of these markets being geared to moderate growth, stock returns from these markets may stall. Long-term however, buying into markets with improving financial and growth characteristics remains a solid strategy.

While the world was upset with a Greek deficit of 12.7% of GDP, it has so far been accepting of a U.S. deficit of over 10% in 2009. There are important differences, particularly when looking at total

debt to GDP, economic growth rates, and flexibility of currency and interest rates, that make a current U.S. dollar and funding crisis unlikely. Furthermore, with the crisis in Europe and a Japan that may finally be moving to effectively devalue the yen, the U.S. remains the only market capable of absorbing the large flows of capital that come from the problems of the "old" world. But being the least impaired should be of little long-term comfort. The various fixes for what is becoming a large structural, entitlement-related deficit will likely reduce growth in the U.S., making us even more comfortable with expanding investment in the new "new" world.

Mr. Woolbert is Senior Vice President and Chief Investment Officer at Pennsylvania Trust.

Painting Profile

Pennsylvania Trust is proud to feature the work of artists such as Kenneth Denton. Born in Kent, England in 1932, he was educated at the Rochester School of Art and Medway College of Art.

With over 40 solo exhibitions to his credit, he is renowned as a contemporary master of landscapes and marine painting, continuing in the tradition of Constable and the Norwich School. His prizes have included the prestigious Hunting Group art awards.

Mr. Denton is a member of the Royal Society of Marine Arts and the International Society of Marine Painters. He is also a fellow at the Royal Society of the Arts. He travels extensively in search of his subjects, painting in many parts of Europe and the British Isles.



Kenneth Denton, *In The Kennet Valley*, oil on panel

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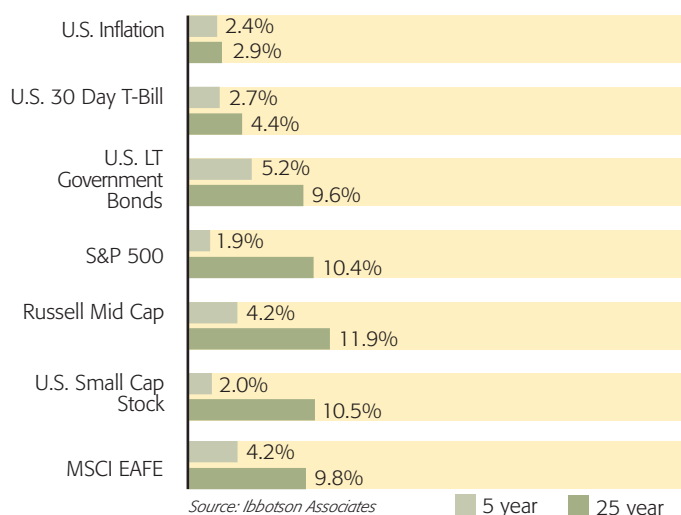
Pennsylvania Trust is committed to conduct all our relationships with integrity and to maintain the highest ethical standards; provide outstanding professional and personalized services; produce superior investment results consistent with client objectives; and retain exceptionally skilled individuals, empowering them with state-of-the-art technology.



Market Indicators

	Current	Three Months Ago	One Year Ago
Stock Indices	3/31/10	12/31/09	3/31/09
Dow Jones Industrial Average	10,857	10,428	7,609
Standard & Poor's	1,169	1,115	798
U.S. Treasury Yields			
2 Year	1.0%	1.1%	0.8%
5 Year	2.5%	2.7%	1.7%
10 Year	3.8%	3.8%	2.7%
30 Year	4.7%	4.6%	3.5%

ANNUALIZED RETURNS OF SELECT ASSET CLASSES



CORE LARGE CAP DIVERSIFICATION

In order to maintain a well diversified large cap common stock portfolio, we recommend the following relative sector weightings within the Standard & Poor's 500:

S&P 500 Sector Weightings	Pennsylvania Trust	
Consumer Discretionary	10.3%	=
Consumer Staples	11.9%	-
Energy	10.4%	+
Financials	16.8%	-
Health Care	11.7%	+
Industrials	10.2%	=
Information Technology	19.4%	+
Materials	3.3%	+
Telecommunication Services	2.7%	=
Utilities	3.3%	=

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