



FALL 2008



trust & investment  
*perspectives*

## A Tale of Two Cities by Nils L. Berglund



**A**s fate would have it, the current crisis in the financial system is hitting its crescendo at precisely the same time as our quadrennial political process is at its most highly charged point. However, given that the near-term health and fate of the U.S. economy is on the line, leaders from New York (banking, brokerage and business) and Washington (politics) are working to cobble together and implement a comprehensive rescue plan to address the current crisis. Blame will eventually be tossed around, but, for the moment, setting our financial system on some firmer footing appears to be trumping those instincts. We all know that few leaders in either camp have completely clean hands. Years ago, Washington forced open the mortgage lending window to millions of unqualified borrowers and then encouraged Freddie Mac and Fannie Mae to buy, and subsequently sell, these high-risk mortgages as investments to other institutions. In New York they were more than willing to profit handsomely from massively leveraging these quasi-government investments. The consequence was that any downturn in housing prices or uptick in foreclosures would have a magnified negative effect. The decline in housing prices began and

the valuation of these investments was questioned, setting the downward spiral in motion.

A year ago Fed Chairman Bernanke stated, "It is not the responsibility of the Federal Reserve to protect lenders and investors from the consequences of their financial decisions." The Fed and Treasury tried that route with Fannie, Freddie and Lehman, but as they pulled on the threads, the suit started to unravel. Allowing much more of the suit to unravel would have created too great a problem. Securing the system became the overriding concern and the rescue plan followed the outline set forth by Treasury Secretary Paulson and Chairman Bernanke. A recognized U.S. monetary scholar, Bernanke believes strongly that the primary cause of the Depression was monetary contraction

and that the eventual recovery was not possible without reflation. The initial rescue plan, which involves the purchase of assets at a "hold-to-maturity" valuation from financial institutions, rather than the "fire-sale prices" that existed at the time, puts money back into the hands of the banking system and is a key part of the reflation process.

While we are hopeful that the rescue plan will give a much-needed boost to confidence, it will take time to be implemented and have a discernible impact. For example, the pricing of the assets to be purchased will be a difficult task. Then, once the various institutions have liquidity and are able to lend, there will be some reluctance to make loans beyond the highest rated credits. In many ways, governments here **continued on page 4**

## Pennsylvania Trust Volunteers

Members of the Pennsylvania Trust team continue to be active in the community in a variety of capacities. Carol Wyeth, Senior Vice President, Trust Administration, participated in the Multiple Sclerosis Society City to Shore Ride. Carol was one of the seven thousand riders whose combined sponsorship for the seventy-five mile bike ride to Ocean City, New Jersey raised over \$5 million for the Society.

John McClelland, whose volunteer work as an advocate for cancer patients has been noted before, was an honored guest of the Entertainment Industry Foundation which sponsored the nationally-televised broadcast of "Stand Up To Cancer."



## President's Message

After many tumultuous weeks, I have been reflecting on the seismic changes caused by recent market activity and the reaction by the Federal Government. Indeed, the U. S. Government has just begun the most sweeping intervention into the nation's financial markets since the Great Depression, and perhaps ever. The Treasury Department will begin injecting billions of dollars into the banking system, supplying banks with much-needed capital designed to restore confidence in the financial markets. The Federal Deposit Insurance Corporation (FDIC) will offer increased guarantees on deposit accounts.

The equity markets have reacted with record volatility, the bond market has essentially seized up, and companies which had been titans in the financial services industry have disappeared or are mere shadows of their former selves. What does this all mean for our clients?

What this means, is long days at Pennsylvania Trust, as our dedicated staff diligently works to digest and interpret volumes of information. We know you are

depending on us to communicate how recent financial events affect you and your investments. At the same time, we continue to work toward prudently executing your investment strategies in an ever-changing environment. Nils Berglund's article on page one offers an important perspective on the roots of the financial turmoil as well as thoughts on the months ahead. In this issue's Trust Talk, Irwin Love discusses the structure and layers of protection provided to trustees and trust assets.

Certainly the events in the financial markets have challenged us to the core. But we remain unbowed. Pennsylvania Trust is fortunate to have a solid team of 19 senior officers who constitute 20, 30, and even more years of experience in the trust and investment industry. As such, we bring the perspective of history, having been active in the financial services industry during previous periods of wrenching market turmoil. Additionally, we are fortunate to have a strong parent company, Penn Mutual Life Insurance Company, supporting our efforts. Penn Mutual, rated

AA- by Standard & Poors, represents over 160 years of experience in the financial services business with a robust balance sheet holding over \$14 billion in consolidated assets.

As events unfold, we will continue to actively monitor the situation and communicate our thoughts and recommended action steps in a variety of ways in order to navigate this unsettled financial market environment. Meanwhile, I urge you to take advantage of the resources available to you through Pennsylvania Trust. We welcome your conversation with us regarding questions and concerns. We are here for you.

**Richardson T. Merriman**

*President and Chief Executive Officer*

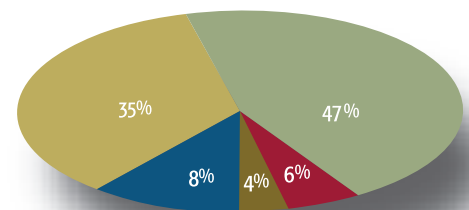
## Charles Sheppard Joins Pennsylvania Trust

We are pleased to announce that Charles L. Sheppard, II has joined the firm as Senior Vice President, as a member of the investment team that develops and implements investment policy, strategy, and security selection.

Chip has over 25 years of experience in the financial services industry, and has held a variety of positions at firms serving both institutional and private clients. He was previously with NorthStar Asset Management, a wealth management company serving individuals, families, endowments, and foundations. Prior to NorthStar, he was a Vice President at Credit Suisse First Boston.

A graduate of Lehigh University, Chip serves on a number of not-for-profit boards and committees. He is President of the Highlands Historical Society and is the founder of the Whitmarsh Township Residents Association.

## Balanced Asset Allocation



- Large Cap
- International
- Mid Cap
- Small Cap
- Fixed Income



### Securing Trust Assets by Irwin S. Love, Esq.

The recent upheaval in our financial and credit markets no doubt has grantors and beneficiaries questioning how their trust relationships will be affected. Complicated financial terms, jargon, and acronyms fill the headlines. Deciphering them is no easy task. The information that follows, while somewhat academic, may prove useful in creating a greater understanding of trust assets, their structures, and the protections afforded.

First, let's consider trust assets in general and their relative safety, irrespective of their investment merit. It is important to understand that a trustee is the legal owner of all assets held in trust — common and preferred stocks of incorporated entities, cash equivalent vehicles, partnerships, real estate, etc.

If your trustee is an individual, it is appropriate for trust assets to be segregated from the individual's own holdings. The individual trustee will likely hold the assets in a brokerage account, titled in his or her name as trustee. The brokerage firm should be a member of the Securities Investor Protection Corporation (SIPC), funded by Congressional Act. SIPC protects a maximum of \$100,000 cash and CD assets with an overall ceiling of \$500,000 for each account owner. Many firms with SIPC coverage also carry excess coverage beyond the overall \$500,000 limit. Some brokerage firms may not be SIPC members for various reasons, therefore investors should look for the SIPC designation.

Note that there may be fact patterns

where SIPC coverage is problematic. These situations include certain trades through a subsidiary held at the subsidiary, commodity futures contracts and investment contracts not registered with the SEC under the Act of 1933. Brokerage margin accounts may present complications in recovery, although it is most unusual for a trust to hold assets on margin.

Trust assets may also be held with a bank or trust company. If an individual trustee opens a bank account with a bank or trust company with depository powers, generally the Federal Deposit Insurance Corporation (FDIC) insures these deposits up to defined limits. The FDIC is an independent agency of the U.S. Government that protects against losses due to bank failure.

As a result of recent legislation each "account holder" is insured up to \$250,000 per owner (until 12/31/09 when it reverts to \$100,000). FDIC limits treat account types separately for purposes of "account holder" status. FDIC insurance does not cover financial products not deemed deposit accounts, such as stocks, bonds, mutual funds, life insurance or annuities, issued by the bank.

Typically trust assets are not held as bank deposits but are held by bank trust departments. These non-deposit accounts are not FDIC insured. Should a bank or trust company fail, the assets held in a trust department account are not considered part of the failed bank's assets and are treated differently. Assets "owned" by the bank as trustee are held for beneficiaries of the trust who are the equitable

owners as opposed to the legal owners. Therefore, the failed Bank's creditors have no claim to trust account assets. Historically bank regulatory agencies (State Banking Department, FDIC, Controller of the Currency, etc.) step in, take control of trust accounts and trust assets, and identify a bank or appoint a "receiver" or "trustee" to take over the day-to-day operation of the trust accounts. Business should continue as usual.

Finally, a word on money market funds (MMF). Recently there has been concern over the quality and liquidity of some MMF. Here at Pennsylvania Trust the majority of our client assets are held with our sub-custodian, SEI Private Trust Co. Each of their SEC-registered MMF will participate in the Treasury Department's MMF guarantee program. Each account will have federal insurance up to the amount held as of September 19, 2008 in a specific fund. Pennsylvania Trust is dedicated to keeping its client assets as safe as possible and partners with companies such as SEI who we believe are similarly dedicated.

I want to assure you that at Pennsylvania Trust, safeguarding our clients' assets remains a key tenet of our fiduciary goals. I encourage you to contact your Pennsylvania Trust administrative officer with any questions or concerns regarding the safety of your trust assets.

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

**continued from page 1** and abroad are stepping in with guarantees for depositors, mortgage holders, and others in hopes of stabilizing the banking system. But investors have become increasingly nervous about the role of the government as a purchaser of assets, especially equity assets. They have seen the impact on equity investors at firms such as AIG, Lehman, Fannie Mae, and Freddie Mac and they wonder who will be next. These steps may have been necessary, but they are nonetheless unsettling for markets. And the economic news, including a crucial variable for the markets – corporate earnings, – is likely to become less positive into the first half of 2009. At this moment, fundamentals are not the driving force in the market. The credit crisis is forcing massive liquidations and investor psychology/sentiment has no counter-weight. As a result, volatility has increased to record levels and will remain an ongoing concern.

If one were looking for a sign to believe that the market is nearing a

fundamental bottom, it might be the investment by Warren Buffett, noted for his long-term investment acumen, in Goldman Sachs. At that time, the rescue plan was being debated in Congress and he perceived that the government would act to “avoid going over the precipice.” Buffett’s decision suggests he clearly saw long-term value in the Goldman Sachs franchise at that price. A short time later Buffett stepped forward with a similar investment in General Electric.

Historically the market has bottomed when the headlines screamed negative news the loudest. Credit crises, plummeting home values, financial system bankruptcies, and government takeovers are typical of just such headlines. Add to that a number of corporate announcements that suggest, at best, a slowdown in earnings growth into 2009, and it seems quite impossible to conjure up good reasons to buy stocks. That’s where history comes into play. We are at historic lows in terms of the rolling 10-year average return for stocks despite a solid earnings performance for many

companies over that timeframe and strong current balance sheets. Most of corporate America is on solid footing and we believe stocks in the long-run represent excellent value.

With our economy likely to lead other developed nations toward recovery sometime in 2009 we increasingly favor domestic investment opportunities going forward. As a result, while our long-term asset allocation for stocks remains at 65%, we are adding more mid and small cap domestic exposure and reducing international. Our stock allocation is 72% large cap, 10% mid cap, 6% small cap and 12% international. The 35% balance in fixed income and cash equivalents includes 5% reserved for reinvestment in equities. At present we are waiting for some stability to return to the equity market before trying to capture the fundamental value created by the decline.

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*Mr. Berglund is Senior Vice President of Portfolio Management at Pennsylvania Trust and a member of the Investment Committee.*

## Painting Profile



Scott Cameron, *Near Onto Haying*, oil on canvas

***Pennsylvania Trust is proud to feature the work of artists such as Scott Cameron. Born in 1946, Mr. Cameron attended Southampton College on Long Island where he studied with Fairfield Porter and Wilhelm de Kooning, followed by Pratt Institute in New York. After college he worked as a graphic designer in Newport, RI, executing the graphics for America’s Cup yachts. This led to painting the simple elegance of America’s Cup races, coastal marsh scenes, timeless landscapes, and historic steamboats, in a style reminiscent of the era in which they reigned. Mr. Cameron currently lives in Delaware.***



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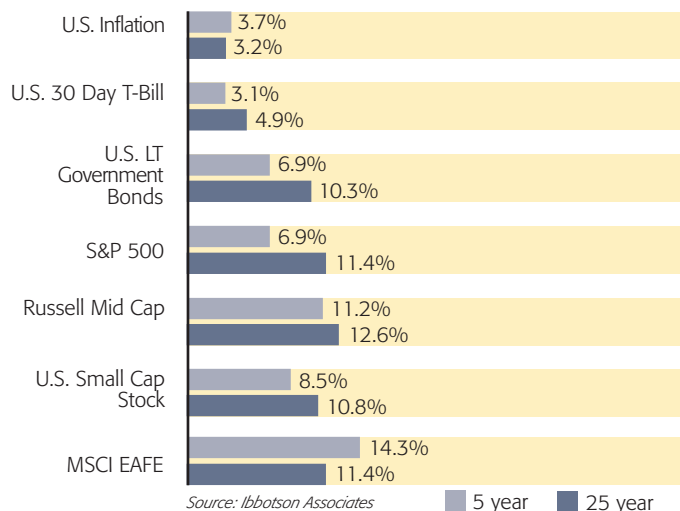
Pennsylvania Trust is committed to conduct all our relationships with integrity and to maintain the highest ethical standards; provide outstanding professional and personalized services; produce superior investment results consistent with client objectives; and retain exceptionally skilled individuals,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

# Market Indicators

	Current	Three Months Ago	One Year Ago
<b>Stock Indices</b>	9/30/08	6/30/08	9/30/07
Dow Jones Industrial Average	10,851	11,350	13,896
Standard & Poor's	1,166	1,280	1,527
<b>U.S. Treasury Yields</b>			
2 Year	2.0%	2.6%	4.0%
5 Year	3.0%	3.3%	4.2%
10 Year	3.8%	4.0%	4.6%
30 Year	4.3%	4.5%	4.8%

## ANNUALIZED RETURNS OF SELECT ASSET CLASSES

Over the past 25 years, equity returns have outpaced bonds, cash and inflation.



## 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	8.5%	=
Consumer Staples	12.2%	-
Energy	13.4%	=
Financials	15.9%	-
Health Care	13.0%	+
Industrials	11.0%	=
Information Technology	16.0%	=
Materials	3.4%	=
Telecommunication Services	3.0%	=
Utilities	3.6%	=

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