



SUMMER 2008



trust & investment perspectives

In Lieu of a Crystal Ball **by Nils L. Berglund**



Recently, in a moment of light-heartedness, a non-investment colleague suggested to me that under the colorful scarf before him was something to help in these difficult investment times. He lifted the scarf to reveal a "crystal ball." Strangely, we both observed the objects in the quartz sphere to be upside down. Perhaps he was suggesting that this was the quickest way for us to find stocks that would go up rather than down. Alas, it would just be an illusion. We needed to look elsewhere for guidance.

The economic issues confronting the investment markets remain unchanged from last quarter: the subprime lending crisis and its impact on the financial services industry; the decline in housing prices and related economic activity; inflation risk owing to rising energy and other commodity prices; a weak dollar; an earnings slump in the financial service and housing-related industries; an anemic employment picture; and collapsing consumer confidence. The Federal Reserve cut rates and added liquidity to the system to ensure that there would be no significant failures to absorb. The facilitation of JP Morgan Chase's acquisition of Bear Stearns was the high water mark for this activity.

None of these issues are fully resolved at mid-year and, indeed, many look worse today than they did three months ago. Headlines today, possibly because we are in a political season, appear more negatively charged. Year-over-year earnings for the second quarter are likely to be down nearly 50% in the financial sector, 20% in the consumer discretionary sector, and 10% for the S&P 500. It is hard to find reasons to be sanguine.

At some point the massive write-downs will end and some degree of normalcy will return to the financial service and housing industries. Their earnings will begin to improve and do so quite noticeably. Third quarter earnings for financials are projected to climb modestly (2%-3%) and consumer discretionary earnings could rise over 13%, resulting in a solid

gain for S&P 500 earnings of over 12%. Comparisons get even easier in the fourth quarter. The S&P 500 is projected to see a 50% gain in earnings, primarily as the result of a projected 450% gain in the earnings for financials from very depressed levels. The 35% gain in S&P 500 earnings forecast for the first quarter of 2009 reflects continued easy comparisons for financials and solid earnings growth across most economic sectors.

The weak dollar has added some fuel to the inflation fire, but it has the advantage of encouraging exports. And those exports have helped keep corporate profits in the U.S. — apart from financials and housing-related firms — expanding. A lower dollar will generally lower imports, but the inelastic demand for oil and the long lead times to **continued on page 4**



Speaker Announcement

Renowned political commentator, David Gergen will be the keynote speaker at our 5th Annual Investor Seminar this October. He will be assessing the challenges facing our next president. Gergen was former advisor to President Clinton, director of communications for President Reagan and administrative counselor to Presidents Nixon and Ford. For over 30 years, he has been active in American politics as a commentator, editor and author. Currently he serves as editor at large for *U.S. News and World Report*.



President's Message

It now seems especially true that there are many more questions than answers regarding the direction of the economy and investment markets. The politics of a presidential and congressional campaign only add complexity and confusion to diverse outcomes rather than provide clarity. I know that I am not alone in my thinking. While on page one of this issue Nils Berglund light-heartedly has a look into a crystal ball for guidance, he provides some thoughtful insights on the direction of the economy and markets and what could be the catalysts for change. As Nils makes clear, there will be no quick reversal of the events and circumstances which have led to the current environment. As our clients expect, at Pennsylvania Trust we have built our reputation on providing practical wisdom and sound investment advice over the years, and we do not intend to waver from this strategy.

In addition to relying on the collective years of experience of the professional team

which serves our clients, we constantly review and analyze trends, reports, and market data as well as calculate hypothetical outcomes of government policy changes. Our responsibility is to provide clients with critical thinking and well-thought-out direction and implementation.

Along the lines of thoughtful solutions, this issue of *Trust & Investment Perspectives* includes a piece on our process for Socially Responsible Investing. This rigorous analysis allows clients the ability to invest in companies whose business practices support their thinking or to screen out those businesses that conflict with their views. In addition, with an article by Bill Widing which highlights the benefits of generation-skipping trusts, we are continuing a discussion begun last quarter on the use of trusts.

For insight into the changing face of American politics and its effect on our economic future, we will turn to national political expert David Gerger, who joins

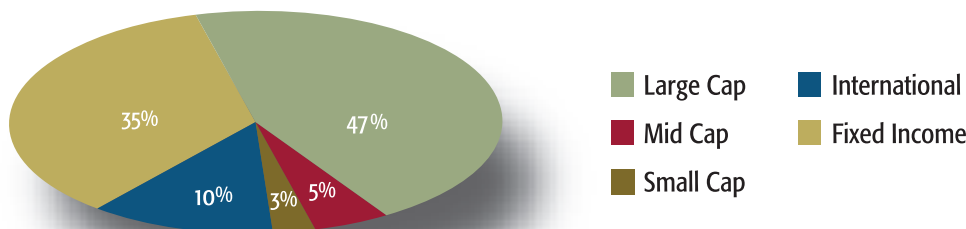
us in October for our annual Investor Seminar. David served as advisor to four former presidents and is currently a columnist for *US News and World Report*. Recently he called on American politicians to "move away from reactive politics and policies and toward future politics." He offers us a glimpse into that future when he addresses "Beyond the Election: What's in Store for the Next U.S. President." We look forward to an energetic and informative presentation and hope you will be able to attend.

Please know that our goal at Pennsylvania Trust is to provide informed perspective, practical wisdom, and expert advice. Uncertain economic times only underscore that commitment.

Richardson T. Merriman

President and Chief Executive Officer

Balanced Asset Allocation



TRUST TALK

Is There a GST in Your Family's Future?

by J. William Widing, III, Esq.



A Generation-Skipping Trust (GST) is an estate planning vehicle that, when properly structured, can offer so many benefits to trust beneficiaries that the beneficiaries themselves may request it. In simple terms, this type of trust benefits at least two generations of beneficiaries, without giving any beneficiary direct access to trust assets prior to the time when the trust is to end by a payout to the younger generation.

GSTs come in many forms, allowing families to choose the structure that serves them best. For example: A daughter and her descendants can benefit by receiving income generated by the trust's assets during the daughter's lifetime. When the daughter passes away, her children receive title to the assets. A GST can also be useful in helping to manage money for beneficiaries who may not be financially responsible. There are many options to consider. Some of the principal benefits follow:

Income Tax Savings

In a properly drafted trust, distributions of income are taxed at the marginal rate of

the recipient. Passing out income to "low rate" beneficiaries can reduce the overall income tax bite on the GST's gross income.

Death Tax Savings

Currently, Federal transfer tax law permits an individual to fund a GST at death with up to \$2 million before either the federal estate tax or the federal generation-skipping transfer tax ("GSTT") kicks in. (Note: Such a gift during life would trigger a taxable gift of at least \$1 million, even though no GSTT is due.) Once funded, the GST can benefit one or more generations by discretionary trust distributions, without increasing the beneficiary's own taxable estate. In this way, the GST may save significant federal estate taxes. In addition, such a plan can save state death taxes as well.

Asset Protection

Family assets paid outright to a beneficiary would be subject to the beneficiary's creditors. A properly drafted GST can keep the assets safe from a beneficiary's personal creditors as long as the assets remain in the trust.

Total Return Investment

A GST design which includes a professional trustee assures the beneficiaries of a tailored investment program seeking total return.

Long-Term Duration

Pennsylvania now permits potentially perpetual GSTs for individuals. Most states have similar rules.

Consistent Administration

Having a corporate trustee to oversee the GST can assure uninterrupted professional management and administration across the generations.

Properly structured, Generation Skipping Trusts can offer a significant financial benefit to families. Pennsylvania Trust's experienced estate planning professionals are knowledgeable and well versed in the specifics of Generation Skipping Trusts. We encourage you to contact us for additional information.

Mr. Widing is Senior Vice President in the Trust Department at Pennsylvania Trust.



Running for Inglis House

Carol Wyeth, Trust Administration, John Grib, Portfolio Management, and Mike Thompson, Business Development, recently donned their running shoes and participated in the Annual Inglis Five Run, a 5 mile race to benefit the residents of Inglis House, a wheelchair community. The event began and ended at Fairmount Park's Memorial Hall. Joining them was John Grib, Jr. who placed 11th overall, and first in the 14-and-under category. Carol and her husband helped to organize the race. Pennsylvania Trust supported the run as a corporate sponsor.

continued from page 1 adjust supply or find alternatives has prevented any adjustment of oil imports at a rapid enough clip to have any impact. On the positive side, earnings generated in a rising currency translate back to the U.S. at a higher level than their simple growth rate – further boosting U.S. earnings growth. The lower dollar also supports investments in the international arena, especially in Western Europe and Japan, as investments that are flat in those countries are worth more in the U.S. when translated into dollars.

While it is too early to say when these negative trends will abate, that we will avoid an “official” recession and that a strong economic recovery will soon follow, it does appear that the U.S. economy is adjusting to this host of issues and more-or-less muddling through. The economy has gained important flexibility/efficiency

over the years from deregulation, global competition and, most importantly, technologically-driven productivity advancements. Energy efficiency has also helped limit inflationary pressures. The U.S. produced ten times more goods and services last year than in 1973, but energy use rose by only a third during that time. Our inflation rates seem quite modest in comparison to other times when inflation was a key concern. Inflationary pressures today are much less structurally derived and are, actually, capable of reversing at some point when the upward spiral in commodity prices ends.

While the signs may not be “crystal” clear, we sense that the U.S. economy may be a step ahead of its major trading partners in experiencing the slowdown, reaching bottom, and preparing to head up. A stronger U.S. economy in 2009, a

result of the Fed’s accommodation, could start to be reflected in stock prices over the second half of 2008. And a stronger U.S. economy would suggest that interest rates are not likely to decline, contributing to a stronger dollar and a preference for dollar-based investments. As a result, while Pennsylvania Trust is maintaining its asset allocation for stocks at 65%, we are shifting toward a more domestic orientation in client portfolios. Within the stock allocation 72% is in large cap stocks, 8% in mid caps, 5% in small caps and 15% in international stocks. The 35% balance in fixed income and cash equivalents includes 5% reserved for reinvestment in equities when we have more confidence in the timing of an economic recovery.

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

Painting Profile



William Hofstetter, *Sunlight and Shadows*, watercolor

Pennsylvania Trust is proud to feature the work of artists such as William Hofstetter (1883-1970). Born into a Philadelphia family of seven children, Mr. Hofstetter learned his craft at Drexel Institute in Philadelphia under Howard Pyle. He then enrolled in the Pennsylvania Academy of the Fine Arts where he studied at night and worked as a commercial artist during the day. There he learned the academic traditions while becoming influenced by the French Impressionists. His free moments were spent painting – first in oil, then almost completely with watercolor. Besides his involvement with various juries and committees in the Philadelphia art establishment, he was a musician and poet, a sculptor and a teacher. From his studio in Glenside, Pennsylvania, he taught both small groups and privately.



PENNSYLVANIA TRUST

Five Radnor Corporate Center
Suite 450
100 Matsonford Road
Radnor, Pennsylvania 19087
610.975.4300
800.975.4316
610.975.4324 F
www.penntrust.com

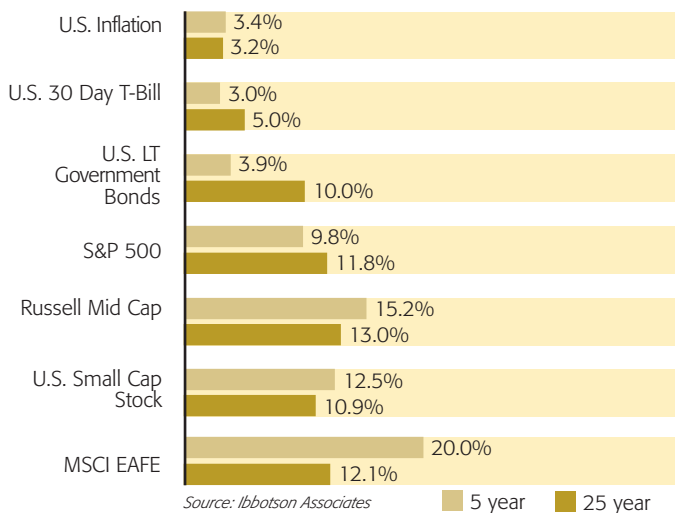
Pennsylvania Trust is committed to conduct all our relationships with integrity and to maintain the highest ethical standards; provide outstanding professional and personalized services; produce superior investment results consistent with client objectives; and retain exceptionally skilled individuals,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

Market Indicators

	Current	Three Months Ago	One Year Ago
Stock Indices	6/30/08	3/31/08	6/30/07
Dow Jones Industrial Average	11,350	12,263	13,409
Standard & Poor's	1,280	1,323	1,503
U.S. Treasury Yields			
2 Year	2.6%	1.6%	4.9%
5 Year	3.3%	2.4%	4.9%
10 Year	4.0%	3.4%	5.0%
30 Year	4.5%	4.3%	5.1%

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	8.1%	—
Consumer Staples	10.8%	—
Energy	16.2%	+
Financials	14.3%	—
Health Care	11.9%	=
Industrials	11.1%	+
Information Technology	16.4%	+
Materials	3.9%	+
Telecommunication Services	3.3%	—
Utilities	4.0%	=

PENNSYLVANIA TRUST



OFFICERS

Richardson T. Merriman
President and Chief Executive Officer

Lee J. Anderson, CFA
Senior Vice President
Chief Information Officer

William H. Haines, IV
Senior Vice President
Director of Business Development

Irwin S. Love, Esq., CTFA
Senior Vice President
Chief Fiduciary Officer

Barbara S. Wood, CPA
Senior Vice President, Treasurer
Chief Financial Officer

Willard N. Woolbert
Senior Vice President
Chief Investment Officer

Pierce Archer
Senior Vice President
Portfolio Management

Nils L. Berglund
Senior Vice President
Portfolio Management

Frederic N. Dittmann, CFA
Senior Vice President
Portfolio Management

JoAnne T. Fredericks, CFA
Senior Vice President
Portfolio Management

Francis R. Grebe, Esq.
Senior Vice President
Trust Administration

John M. Grib, CFA, CFP®
Senior Vice President
Portfolio Management

Jean E. Hunt, Esq., CPA
Senior Vice President
Trust Administration

Larry H. Lehrfeld
Senior Vice President
Tax Administration

George C. McFarland, Jr., Esq.
Senior Vice President
Portfolio Management

Radclyffe F. Thompson, CFP®
Senior Vice President
Business Development

J. William Widing, III, Esq.
Senior Vice President
Trust Administration

Carolyn L. Wyeth
Senior Vice President
Trust Administration

Kenneth R. Brightcliffe
Vice President
Equity and Fixed Income Trading

Kathelene L. Burns
Vice President
Investment Research

John R. McClelland
Vice President
Trust Operations

Monica P. Ruggio
Vice President
Trust Operations

Karen H. Harr
Senior Trust Officer

Debra S. Tongue
Senior Trust Officer

CONSULTANTS

Kevin Fisher
Senior Technology Consultant

Donald E. Lewin, Ph.D.
Senior Investment Consultant

William J. Loble, Jr.
Senior Trust Consultant