

Capital Preservation

Caldwell Trust Company is an independent trust company devoted to providing clients with personalized and focused professional services that safeguard their financial assets while maximizing investment return. Fund managers R. G. Caldwell Jr. and H. Lee Thacker Jr. believe that they can build loyalties with clients through word-of-mouth referrals without the need for mass marketing. The company has three kinds of clients: - individuals, business owners and group employee retirement plans.

Q: What are typical client profiles and what investment returns should people expect in the long term?

A: We have three kinds of clients: individuals, business owners and group employee retirement plans. Each has different needs. For example, a retired couple in their sixties with liquid assets between \$1 million and \$5 million is not working anymore or accumulating assets. They will like to maintain their quality of life and pass on a sizeable amount of their assets to the next generation. Their investment expectations are to generate enough to meet their current spending level and not to accumulate any more.

With high-net-worth clients with liquid assets of between \$40 million and \$50 million, expectations are a little different.

They are less concerned about whether they have enough because they do. What they're more concerned with is how is it managed, protection of their assets, continuity for generations and mitigating taxes. So they are looking for a different kind of service, although it's delivered in a very similar fashion.

The last group of clients we have is employee retirement plans. We manage money for some Employer Retirement Plans as a fiduciary and, as such, we are doing the same thing: collecting money for the individuals of the companies--their employees--and managing that for their retirement.

As far as investment expectations, the bulk of our clients expect us to advise them on asset allocations so that they can take enough money out of their accounts without running out of funds in their lifetimes.

And for the most part, we have been advocating that our clients have most of their money in stocks, except for a short period of time during 2000-2002 when we did recommend reducing allocation of stocks down to about 40%. Since that time, we have built back up and we are in the range of 65% now. Our clients have confidence that we're going to guide them to a place with regard to allocation that maximizes their income and their total return as well as protects their capital.

We manage risks in portfolios through asset allocation. Not all clients are cre-



R. G. "KELLY" CALDWELL, JR. is CEO and president of Caldwell Trust Company and its parent, Trust Companies of America, Inc. In 1988 he joined his father, Roland, at what was then Caldwell & Company. They started Caldwell Trust Company, which has grown to three locations on Florida's Gulf Coast with approximately \$420 million dollars under management in mid-2007. Caldwell has guided CTC in designing, developing and implementing proprietary integrated computer software.



H. LEE THACKER, JR. joined the firm in 1996, and is a director, vice president, secretary, and trust officer of Caldwell Trust Company and a director of its parent company.

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ated equal, and so we do manage to the individual client’s risk tolerances. But there are similarities in how we approach stocks. We prefer to invest in large-cap, well-known stocks. Generally one finds them in the Dow Jones Industrial Average. These stocks form the core of our holdings. We also have “satellite holdings” that provide consistent dividends. What we are trying to do is to represent the market in our portfolios rather than beat the market. In addition, we have a list of Top Ten consistent growth companies that we like, and we invest in these stocks when the opportunity is right. We get our international exposure through various exchange-traded funds or ETFs.

Historically, in the long run, portfolios with 60% in stocks and 40% in bonds with a long-term investment outlook can generate between 6% and 9%. Currently we are advising clients to expect between 6% and 8%. Historically, when you view the market with a 55-year moving average, one can expect to earn a 9% return, which includes several periods of high inflation. Recently inflation has been low, so return expectations reflect that too.

Q: How important it is to set investment goals and understand client expectations?

A: Well, that is a challenge and I will take you back to the tech bubble in 2000. If you go back to that timeframe when the NASDAQ did an 80+ percent

return rate one year, you look at that and you say, “Everyone should be able to make that.” This is just human nature. Clients that have reasonable expectations are more apt to achieve their goals. However, it does come back to the goal-setting and risk management of that client. How can we know what the market can deliver for our clients if they do not understand their expectations and what is possible with those expectations? If necessary, we explain to them the range of possibilities. Nevertheless, that can change over time as the client’s outlook changes because their time horizon changes based upon their family circumstances, age and occupation status.

It is important for clients to understand that the market is only going to deliver what it delivers because certain elements influence the market. It comes in at an infrequent or an unpredictable pattern, both daily and monthly. As a fiduciary, we are not traders. Our growth component in the portfolio does have some turnover that is a little bit inconsistent with a fiduciary, but that volatility and turnover comes with growth investing. Our clients tolerate it because it is a small allocation of approximately 10% and it is generally appropriate for younger clients.

Q: What do you communicate to new clients and how do political cycles matter?

A: Our impression is that very few people are interested in management skills or investment expertise, because when the market is doing well everyone is doing well, too. However, when the markets do poorly, clients realize they must pay attention to their money. When this occurs, we find that our services are much more in demand because the market volatility provides some incentive for them to come seek us out.

Conversely, during the late nineties, very few people were interested in our

services because they were unaware that the market growth was unsustainable. This period was a one-time correction to properly value securities that were grossly undervalued. It went a little too far in some areas and it recovered. Now it is back to a more normal trajectory.

Today we believe that for a normal growth environment, stocks are undervalued on a risk-adjusted basis. Therefore, you can confidently own quality stocks and have some dividend components that have a tax advantage to them versus owning non-dividend paying stocks. That is why we are a little bit more comfortable today.

But our caveat to our clients today is that, as a result of whatever happens in November, we are very cautious about changes resulting in a tax policy that is not pro-growth, that increases taxes dramatically, or establishes protectionist trade policies. These are all bad for capital assets and we may have to adjust our portfolio and investment expectations after the Presidential elections.

Similarly, a couple of things happened in 2003 that were noteworthy. Capital gains tax was lowered to 15% and tax on qualified dividends was capped at 15%. That was a huge change, and we wanted to take advantage of that by owning stocks that paid good dividends. We were able to ramp back up on equity exposure across our portfolios because of the risk compensation. There was a higher after-tax return by being in a dividend-paying stock rather than in bonds.

Q: How do you construct a portfolio? Do you allocate among different funds or do you pick stocks?

A: We like to have core stocks as large-cap companies that are household names--and many of them you find in popular market averages like the Dow

Jones Industrial Average--along with a number of individual securities that we like and follow. In addition, we have stocks that pay a consistent dividend and those with international market exposure thorough various ETFs. We follow that pattern throughout when reviewing accounts, while keeping in mind the risk tolerance and needs of individual clients. We manage with individual securities. It is a rare instance when we will use a mutual fund. The mutual funds that we do own are generally the ones that clients brought with them in their portfolios.

Our investment committee sets a broad portfolio allocation like a baseline. Then individual portfolio managers, as they are dealing with their individual clients, move up and down away from that baseline in the different areas. Our baseline would have something like 25% to 30% core holding of quality stocks. It might have a 15% large-cap, a 15% international, 10% growth, 15% dividend-yielding stocks and the balance made up with income-yielding securities. When that allocation is set, it is a matter of taking those building blocks and managing them individually. A portion of the growth component may include our Top 10 Growth Model, a portfolio we designed. In a million dollar portfolio we might invest 10 % in our Top 10 model, or \$10,000 in each of the 10 stocks. We track the model closely and replace the stocks when they no longer meet our criteria.

For a diversified portfolio, we do not want to have more than 5% of any one security in the client's account unless it's a U.S. Treasury bond. Within the income allocation, we would consider utilizing bonds, preferred stocks such as Royal Bank of Scotland yielding 7%, or even common stocks regularly paying good-quality dividends such as Plum Creek Timber, FPL or Genuine Parts to meet the income needs of our clients.

Our job is to build the components to match the needs and risk tolerances of our clients. We are the conservator of their assets. In order to protect their wealth, we place a higher priority on managing risk through appropriate asset allocation. Performance is secondary to preservation in our investment strategy.

Q: Why do you not prefer to invest in mutual funds?

A: Our philosophy is that we will not take a commission on any product. We do not have any products to sell. We do not sell annuities, life insurance or load mutual funds. The only thing the client pays is a fee based on the average outstanding balance in the account. They see that fee on their statement every month. That is one of the reasons that we do not buy mutual funds, particularly those with loads and 12(b)-1 fees. In addition, our clients buy and sell stocks for 3 cents per share because that is what we pay. I would like to say we are on the same side of the table as the client and they know exactly what they are paying us. Moreover, that sets us apart from many other institutions.

Q: Generally, what do you think about risks and how do you manage them? Do you also apply risk-control measures at the industry or sector level as you do at the individual stock level?

A: We do monitor the sectors. We have so much diversification in the way that we have it. However, we have never seen a sector issue arise. Nevertheless, we are describing a very remote situation here because that is not our typical client by any means. I say that with one grain of salt because being in the trust industry, we own many securities, and hold on behalf of our clients many securities that I would consider heirlooms. We have clients that have exposure to Exxon Mobil that, no matter what I tell them, they will not give up. As a result, we do have exposure


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when a client directs it in these heirloom situations. They are typically in companies like Exxon Mobil, GE or Coca-Cola because the client accumulated that asset in the first place. Most of the time, we try to work with the client on a structured sale policy to sell in strength. When it does strengthen, we take the little bit of gains over time to keep bringing that equity exposure down.

We recently worked with a client with a lot of exposure to bank stocks. We were able to convince the client to begin a sales program and we have sold or gifted some every year. In spite of that, the client suffered significant losses in the last six months. We met with the client just a couple weeks ago and did significantly more sales to get the exposure down to 10% of its original holding, but this is a client who resisted selling because of emotional attachments. However, that is not our typical client. 

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