

# The Atlantic Trust Advisor

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## Stay the Course: Navigating Challenges and Opportunities

*In 2008, Atlantic Trust responded to clients' concerns about the financial services meltdown and extraordinary market volatility with increased communication and strategically prudent portfolio adjustments. As we move into 2009, a good old-fashioned cliché—"stay the course"—comes to mind, says **Jack Markwalter, President and CEO**. Markwalter shares his thoughts about why Atlantic Trust is well situated to help clients navigate the significant challenges and opportunities that lie ahead.*



**"We are all faced with a series of great opportunities brilliantly disguised as impossible situations."**

—Charles R. Swindoll (b.1934), minister, author and educator

The sentiment in this quote is relevant to what clients and Atlantic Trust alike are presented with. "The environment of 2008 really tested all of us," says Markwalter. "But it validated our platform of providing customized portfolios tailored to each client's risk profile and objectives, access to a wide range of diversified investments, and a high level of client service and communication. This is the foundation with which we move into 2009."

The firm's investment philosophy and wealth management approach are

based on client objectives—portfolios are designed to balance each client's financial goals with the client's tolerance for risk, cash flow requirements and other factors. "Many of our clients had significant exposure to fixed income as part of their overall asset allocation," says Markwalter. "As a result, they were better able to withstand the market decline last year, although not without any loss of value to their investments." Importantly, Atlantic Trust's clients have largely avoided permanent impairments of capital, such as what occurred

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## Stay the Course: Navigating Challenges and Opportunities

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with Lehman Brothers and other failed institutions, where there is little or no further opportunity for those securities to recover.

Atlantic Trust's emphasis on broad diversification across domestic and international asset classes in equities, fixed-income and alternative investments also helped to minimize the market's damage to client portfolios. "In a number of cases we had an allocation to market-neutral hedge funds," comments Markwalter. "These funds historically have been flat or up, even in difficult environments. Last year, they fell—but significantly less than equity-only portfolios and less than the equity market as a whole."

Another distinguishing strength is Atlantic Trust's exceptional client service provided by its industry veterans. "In direct response to the increasingly challenging environment, our teams gave higher levels of professional attention and responsiveness to our clients," says Markwalter. The firm's relationship managers, investment team and Wealth Strategies Group spent more time meeting with clients and their families, reviewing their portfolios and estate plans and addressing their concerns. "Our professionals have broad industry experience, averaging more than 22 years each, which is very helpful both in terms of the quality of their advice and the perspective they bring to each situation."

The personal relationship between clients and their Atlantic Trust advisor is critically important, but Markwalter also stresses the bigger context in which the firm operates. "Atlantic Trust is solely in the business of wealth management," he adds. "We are not in commercial or investment banking, which allows us to keep our focus on our core mission. And the reputation and strength of Invesco, our parent company, offers stability and leadership in challenging market conditions."

### Anticipating the Opportunities of 2009

Even as Atlantic Trust supports its ongoing commitment to protect clients' assets, the firm's leadership is focusing on opportunities in 2009. Jeff Thomas, chief investment officer, has an investment strategy in place designed to preserve client assets through this downturn and position them to take advantage of a market recovery. Markwalter notes, "Going forward it will be critical for each client to focus on his or her long-term plan, remain diversified across asset classes and maintain appropriate liquidity. In difficult markets, people are inclined to reduce their equity exposure, yet stocks are much more attractively valued now than they were at this time last

year. If you make substantial changes in your asset allocation, you may lose the ability to participate in the rebound."

Markwalter anticipates that over the next 12 to 18 months, as Washington's new administration's initiatives and policies take shape, there will be new investment opportunities and that wealth planning will play a more important role. He says, "The Wealth Strategies Group, led by Linda Beerman, will keep Atlantic Trust's relationship managers and clients informed in order to respond proactively to changes in income, capital gains and estate taxes."

Atlantic Trust is also strategically aligning its resources to benefit clients. Last year, Eric Propper, managing director in New York, led an initiative to establish a \$5 million minimum for new client accounts. Larger accounts are better able to fully leverage our wealth planning resources and the breadth of asset classes we offer. In a volatile market, accessing the best investment managers in each asset class, wherever they may be, is key to protecting and growing clients' capital. The hands-on service Atlantic Trust provides is also well suited to more substantial accounts, according to Markwalter. "We feel we can do a better job of really knowing the client and tailoring our services to his or her needs if we limit the number of clients per relationship manager."

Markwalter strongly believes Atlantic Trust is better positioned than its competitors to take care of clients in these uncertain times. "We have a unique blend of highly customized asset allocation expertise, access to investment managers across a wide range of asset classes and excellent personal service," he says. "In Invesco, we have a parent with strong leadership and deep resources. In terms of stability, liquidity and staying power, that's a competitive advantage in today's challenging environment. We are committed to protecting and growing the assets of the clients that we're privileged to serve." ■

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**Jack Markwalter** is president and chief executive officer of Atlantic Trust, as well as chairman and chief executive officer of Invesco National Trust Company. He is a senior managing director of Invesco and serves as a member of Invesco's Executive Management Committee. In 2008, Markwalter took on an additional role as head of U.S. Institutional Sales, Consulting and Client Service for Invesco's Worldwide Institutional business and also managing the operations of Invesco's private equity fund-of-funds business, where he works closely with Wilbur Ross, founder of WL Ross & Co. and chairman of Invesco Private Capital. Markwalter joined Atlantic Trust in 2002 as head of business development and has more than 20 years of experience in the private client and investment industry. Prior to joining Atlantic Trust, Markwalter served as managing director and national director of the client strategy group for Morgan Stanley Private Wealth Management. Jack earned a Bachelor of Science with highest honors from Georgia Institute of Technology and a Master of Business Administration from Harvard Graduate School of Business Administration. Markwalter serves in various leadership roles for many community organizations. Among other positions, he is a member of the Board of Trustees for the Georgia Tech Foundation, the Board of Trustees for Pace Academy, the Board of Directors for St. Joseph's Hospital Mercy Foundation, and he serves as chairman for his Harvard Business School Reunion Fund Campaign.

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## Family-Owned Businesses Need to Plan for the Future

*The Wealth Strategies Group at Atlantic Trust integrates estate, financial and investment planning through sophisticated assessment of goals to achieve multi-generational capital preservation, family business continuity and strategic philanthropic objectives.*

The economic downturn has caused many clients to view the family business as one more asset to be reevaluated in light of recent events. Among those who consulted Atlantic Trust advisors during the fourth quarter of 2008 were an entrepreneur who recently sold his company and wanted to invest the proceeds, another who was thinking of cashing out because sales had drastically declined and a third who wanted to transfer business assets to family members while values are low.

“Whatever their long-term goals and assumptions about the economic viability of the company, it is a good idea for every family-owned business to have a succession plan,” says Daryl M. Allen, senior vice president at Atlantic Trust. Most such enterprises do not continue to the third generation. Advance planning may improve those odds.

Atlantic Trust advisors have helped clients work through many issues in the context of business succession planning. Following is a discussion of the most common issues that arise.

### **How much is the company worth?**

“Answering this question is a prerequisite for various forms of succession planning, from transferring shares to children to selling the company,” says H. Arthur Graper, senior vice president at Atlantic Trust. In the life of a business, value can fluctuate—for example, as a result of market conditions or because there is a liquidity event on the horizon.

Disappointing as it may be in the current economic environment to learn that the value of the business has gone down, that information can also help you chart a realistic course for the future. For instance, advisors who work with companies in financial distress may be able to help put the business back on track or find a buyer.

### **How long should you stay involved?**

“Company founders often think of the business as an extension of themselves, and that makes letting go an emotional issue as much as a practical one,” says Linda S. Beerman, managing director at Atlantic Trust. Those who have been grooming another family member or key employee to take over the reins may be reluctant to relinquish control.

### **What are your other income sources?**

Even if psychologically you are ready to step down, you may not be able to do so without the steady salary, health and retirement benefits you have been receiving from the business.

“Instead of giving up everything, it may be possible to continue the income stream by carving out a role as a consultant or part-time employee during the transition to family management or new ownership,” says Judith A. Saxe, managing director at Atlantic Trust. Another possibility is to structure a transaction, whether with family or a third party, that involves an installment sale or a loan that will continue to generate revenue for the original owner. There might also be real estate or other income-generating assets that can be used for substitute retirement income.

### **Who is the likely successor?**

“This is a potential lightning rod for many families, especially when the candidates include both family members and outsiders, such as key employees or in-laws, or when some children are involved in the company and others are not,” says Graper. In the most successful transitions, owners have taken steps to minimize future conflicts—for example, by having children begin their careers and gain experience elsewhere, before assuming a role in the family enterprise, and by equalizing inheritances with other assets.

### **Is there a buy-sell agreement?**

By requiring a sale under certain circumstances, known as trigger events, and specifying the terms beforehand, a buy-sell agreement avoids conflict and protects everyone. Ideally, it should cover what will happen to an owner’s interest in a range of circumstances, including death, divorce, retirement, personal bankruptcy, transferring assets to family members, starting a competing business or offering shares to an outsider.

Buy-sell agreements can take a variety of forms. In a cross-purchase agreement, the option or obligation to buy out an owner or heir belongs to the remaining owners. Alternatively, you can use a redemption agreement, which designates the company as the buyer. A hybrid approach typically gives an owner the right of first refusal, with the company next in line if the owner does not exercise it.

“Business owners should also think about payment terms and financing ahead of time,” says Allen. A lump-sum payout is often associated with life insurance that is used to finance a buyout when an owner dies. The alternative is an installment sale, with payments plus interest over a defined period. These arrangements are common in buyouts where the owners do not anticipate a ready source of cash, which could happen if one owner gets divorced or wants to leave the business.

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## Family-Owned Businesses Need to Plan for the Future

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### Should you transfer shares?

If your company has recently declined in value, this may be the ideal time to give away partial interests in the business to younger family members. In this atmosphere, it may be possible to transfer more shares of the business to family before you hit the legal limits on tax-free gifts.

Currently, you can make gifts of up to \$13,000 in cash or other assets each year (\$26,000 if you are married) to as many recipients as you would like without incurring gift tax. In addition to this annual exclusion, you can give away \$1 million during your life (\$2 million for married couples) before a 45% gift tax applies. Various estate planning techniques designed to minimize or avoid gift tax altogether can pack even more value into both the annual exclusion and the lifetime exemption amount.

Some parents ask children to pay for at least part of the share of the business that they are receiving, rather than treating the whole transfer as a gift. "These arrangements are most prevalent in situations when one child is involved in the company, and the parent does not have other, comparable assets to give another child who is not," says Saxe.

### How will your family pay estate taxes?

"Estate taxes often present difficulties for family business owners, particularly when the business is illiquid," says Rebecca W. Milliman, vice president at Atlantic Trust. Normally, heirs must pay estate tax within nine months of the death of the senior family member. A substantial estate tax bill could force heirs to sell key assets or even lose the company. Loans for this purpose, which might have been available in the past, may be much harder to get in today's tight credit market.

The simplest alternative may be to buy life insurance that would cover the tax bill. Depending on the circumstances, the purchase can be by either the business owner or the business. The owner would typically establish an irrevocable life insurance trust, which can buy the policy and manage the proceeds in accordance with the terms of the trust at the business owner's death. If the company purchased the insurance directly, the proceeds may be used to redeem the deceased shareholder's interest in the business up to the amount of the estate taxes.

Depending on the circumstances, your family may also be able to elect to pay the estate tax in installments. Although the rules are complex, Atlantic Trust advisors can help you determine whether this option is available.

Although the considerations in managing the transition of a family business are complex and often intertwined, talking with a professional who has helped others deal with the challenges can be a valuable first step. Your Atlantic Trust advisor is ready to take that step with you. ■

### Post-Election Tax Update

With the election of Barack Obama and Democratic gains in both the House and Senate, tax changes are in store. The major income and estate tax proposals made by President-elect Obama are outlined below.

#### Income Tax Proposals

- Raise the top two income tax rates to 36% and 39.6% for families earning more than \$250,000 (\$200,000 for singles). The 10%, 15%, 25% and 28% income tax brackets remain unchanged.
- Increase the capital gains and dividend tax rate to 20% for taxpayers in the top two brackets while maintaining the current rates in the lower brackets.
- Extend and index, for inflation, the Alternative Minimum Tax patch, which currently is \$69,950 for joint filers and \$46,200 for single filers.

#### How will taxpayers fare?

- A family of four earning \$500,000 from various income sources may expect a tax increase of \$3,100 based on the proposed tax rate changes. A single taxpayer earning the same amount as the family may expect a tax increase of \$11,500.

#### Estate Tax Proposal

- Make permanent the estate tax exemption amount of \$3.5 million per person along with the top marginal tax rates for estates and gifts of 45%. The gift tax exclusion will remain at \$1 million.
- Portability of first spouse's unused estate tax exemption to be used by surviving spouse.

#### Increase to Annual Gifting Limit

- The gift tax annual exclusion increases to \$13,000 in 2009, creating new planning opportunities.

#### Deferral of 2009 Required Minimum Distributions (RMDs)

- New legislation was signed by the president that will allow owners and beneficiaries of IRAs and other defined contribution plans 70½ years of age or over to suspend without penalty required minimum distributions for 2009. ■

Source: [www.deloitte.com](http://www.deloitte.com)

## Top 2%: Equity Income Strategy

An Interview with Paul McPheeters, CFA and Doug Rogers, CFA, Co-Managers

The Atlantic Trust Equity Income Strategy ranked in the top 2% of all Large Cap Core Funds tracked by Lipper for the 5-year period ending 9/30/08\*. That's an outstanding achievement in a very challenging market. Since its inception, this value-tilted core equity strategy has consistently delivered favorable returns with lower than average volatility. (See box below.) Atlantic Trust asked Co-managers Paul McPheeters and Doug Rogers to talk about the investment strategy behind this impressive track record.

### Q What differentiates the Atlantic Trust Equity Income strategy from its peers?

A In looking for investment ideas, we have the flexibility to search across a much broader universe of securities to own than is typical for most of our peers with narrower mandates. Additionally, we do not have a mandate to closely match any index, so we have more ability to enhance the strategy's return through successful stock selection. We stay diversified across sectors, but because our strategy is based on bottom-up fundamental analysis, we often have multiple holdings in the industries where we see the best opportunities.

Also, the strategy focuses on high-quality companies. This generally reduces the strategy's downside risk and allows us to hold positions for a longer horizon, which also enables greater tax efficiency. We believe the level of cash flow generation and the future growth outlook for that cash flow are the best gauges of a company's value. Therefore, we invest in companies that are undervalued

relative to their ability to generate free cash flow over a multi-year horizon. The companies that meet our criteria tend to have smart management teams, conservative balance sheets, low levels of capital intensity, high levels of cash flow and the ability to grow their cash flow for many years into the future.

Lastly, we are focused on the level of cash flow generated, not the level of dividends being paid. In contrast, many of our peers have invested a greater percentage of their portfolios in typically high-dividend areas, like banks, utilities and REITS, in order to boost their overall yield.

### Q Given your investment criteria, are there any industries you have found to be consistently better areas for investment?

A We have been consistently overweight in natural gas producers. We think natural gas prices have more downside protection than many other commodities, due to the steep production declines that will occur when there are material cuts to capital spending in the industry. The quality companies in this field have been able to grow both their volumes and excess cash flow. We have also tended to favor health care services, which have extremely high levels of free cash flow. A lab outsourcing company, for example, has the advantage of good secular trends from the aging population, leading to consistent mid-single digit growth and very consistent cash flow.

We do not buy anything we think will fail to return at least 10% over the next 12 months, which is a function of both favorable valuation relative to the company's free cash flow generation and what we believe to be a conservative estimate of its growth for the next 2–3 years. As a result,

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## Favorable Returns and Lower than Average Volatility

Through September 2008

	Manager vs. Benchmark Return				Manager vs. Benchmark Standard Deviation				Manager vs. Benchmark Beta			
	YTD	1 Year	3 Years	5 Years	YTD	1 Year	3 Years	5 Years	YTD	1 Year	3 Years	5 Years
Atlantic Trust Equity Income III	-14.12%	-16.09%	3.22%	10.08%	4.89%	5.30%	9.05%	9.88%	0.64	0.65	0.80	0.89
Atlantic Trust Equity Income III (net)	-14.62	-16.77	2.28	9.00	4.88	5.28	9.00	9.83	0.64	0.65	0.79	0.89
S&P 500 Index	-19.26	-21.95	0.23	5.18	6.25	6.86	10.83	10.72	1.00	1.00	1.00	1.00
Russell 1000 Value Index	-18.85	-23.56	0.09	7.12	3.08	3.05	11.13	11.33	0.42	0.36	0.97	1.01

Source: Zephyr StyleADVISOR. A portfolio's beta measures its sensitivity to market movements. The overall stock market has a beta of one. A beta of 1.25 indicates a portfolio has been 25% more volatile than the market; a beta of 0.75, that it has been 25% less volatile. Standard deviation is a measure of a strategy's average monthly performance compared to its range of monthly returns from high to low. The lower its standard deviation, the less volatile the strategy is likely to be. Net of fee returns reflect a maximum annual management fee of 1.2%.

\*There are 593 funds in the Lipper Large Core Universe. The strategy was ahead of its benchmark in fourth quarter; however numbers were not available at time of press.

Past performance is not a guarantee of future results. Data not annualized if less than one year.

## Top 2%: Equity Income Strategy

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even though there are some great businesses in the sector, we have typically been underweight in consumer staples because their valuation is rarely discounted. We do not find as many stocks there that we believe can make the 10% return threshold. We should note that in the current market environment, we have been able to find a few, select consumer staples companies in which to invest.

### Q What is the greatest challenge in today's market?

A Investing during a recession in a market this volatile is both challenging and full of opportunities. The question is not whether the economy will recover, but at what point will the market begin to reflect that recovery. We are taking care to maintain our quality focus and minimize balance sheet risk to avoid any disasters, while positioning the portfolio to outperform when markets improve. Focusing on names that can produce solid levels of cash flow during the recession is critical to minimizing risk.

We are finding attractive opportunities in 80% of sectors, not just one or two areas. This includes extremely high quality names—market leaders with great business models—that we have never had the chance to look at until now because they had never moved into our valuation range. This puts us in a unique situation, as it actually allows us to upgrade the quality of the portfolio even higher than it has been historically. Despite not knowing exactly where the market bottom will be, we have a lot of confidence that these stocks will be trading substantially higher a few years from now and that our investors will benefit from these moves. ■

*Any reference to a ranking, a rating or an award provides no guarantee for future performance results and is not constant over time.*

## Harvest, Preserve and Grow

Recent comments from President-elect Obama suggest he will move forward with his campaign tax plan of an increase for earned annual incomes of more than \$250,000—with a threshold of potentially \$150,000—and cutting taxes for most others. As no clear statement has been made, it has added to the continuing uncertainty in the markets.



Dee Ann Schedler  
Managing Director  
Atlantic Trust

In light of this, we have recommended that clients opportunistically harvest tax losses this year while the market is low, as those tax losses can be carried forward indefinitely and may be more valuable in future years, as tax rates may rise. We are also recommending adding a diversified portfolio of individually managed municipal tax-free bonds. They can offer relatively high after-tax yields, which may improve with rising tax rates, and their valuations have been compelling and could still be for a short period of time this quarter, said Dee Ann Schedler, managing director-Washington D.C. "This can add a valuable component to a client's overall asset allocation in lowering the volatility of their portfolios and preserving assets," adds Schedler.

As we continue to conduct reviews—which we recommend at least annually—there is a renewed focus on a client's investment objectives/goals, risk tolerance and asset allocation. This exercise really helps our clients to reassess long-term goals versus current needs. "We discovered a few clients' objectives changed and so we adjusted their asset allocations to have less stock exposure," said Schedler.

Most clients are long-term investors who remain confident that their broadly diversified portfolios will return to a long-term trend of growth, and they are not seeking to sell out of their stock positions, other than opportunistic tax-loss harvesting. As each situation is unique, please speak with your advisor to determine what is right for you. ■

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