

Patrick J. McNamara, MSFS  
E-mail: pmcnamara@finconcepts.

*Financial Concepts, Inc.*  
A Member Firm of M FINANCIAL GROUP  
617 Detroit Street, Suite 120  
Ann Arbor, MI 48104-1112

Tel: (734) 214-9770 • Fax: (734) 214-9771

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### in this issue:

Investing in a  
Global Marketplace

To Be Continued...  
The Art of Business  
Succession Planning

## Understanding Mutual Fund “Styles”

Many people are very style conscious when it comes to automobiles, clothing, and homes, but they may be far less discriminating about their choice of mutual funds. What, you may ask, does style have to do with investing?

Fund names are sometimes confusing. If you were to invest in an **aggressive growth fund**, a **growth fund**, and a **growth and income fund**, would you have achieved a measure of **diversification**? Perhaps. But then again, perhaps not. In its simplest form, style analysis provides detailed information on the make-up of an investment portfolio. As such, it provides a look behind the “label.”

Looking inside a fund is useful because investment styles are related to both **performance** and **risk**. Since the economy tends to be cyclical, different companies (and their stocks) perform better at different stages of the business cycle. In constructing a well-diversified portfolio, it is important to understand how, and to what extent, different asset classes affect performance.

Here are some general guidelines for three common mutual fund styles:

- **Growth funds** look for companies whose profits are rising (that is, have “positive earnings momentum” in Wall Street parlance). Such companies have high rates of earnings growth and tend to have high **price/earnings (P/E) ratios** (a measure of a stock’s price relative to company earnings), because investors are willing to pay higher prices for greater earnings potential.
- **Value funds**, on the other hand, look for stocks that are relatively cheap compared to their asset value. This means that if all of the company’s assets were broken out and sold separately, the amount realized would be more than the total value of all the outstanding stock. In market speak, such stocks have a “low price to book value” (i.e., they are undervalued) and tend to have a lower P/E ratio than growth stocks.
- **Blend funds** try to have it *both* ways—buying both types of stocks in varying degrees, depending on a perception of where the market is heading. Their strategy is a little like hedging a bet—that is, sacrificing the potential highs of a pure growth commitment in order to avoid the potential lows of being too concentrated in a few “hot” areas.





## To Be Continued... The Art of Business Succession Planning

In order to preserve your company's success, it is imperative to develop a solid business continuation plan. Whether you ultimately expect to transfer your business interests to family members at retirement or sell to a third party, planning can help ensure your wishes are met. It can also help you prepare for a transition at your death or in the event of disability. On the occasion of any of these events, a business succession plan provides your co-owners, management team, employees, and family members a blueprint for continuing operations.

With a business succession plan, you can help secure the future of your business, minimize estate taxes, and maximize the wealth passed on to the next generation. To be successful, you need to examine your immediate, intermediate, and long-term goals for both your family and your business.

### *Developing an Exit Strategy*

One of the first planning steps is deciding on a successor. If you wish to keep ownership and control of your business within your family, you will need to assess your family members' interests and qualifications in light of your company's needs to determine who will participate and in what capacity. Business owners often must decide how to fairly compensate those who will work for the company, as well as nonparticipating family members.

If you expect unrelated parties to carry on the business, you will need to meet with the key people for in-depth discussions about the company and its future. Communication is

essential. Everyone involved, from family to management, should have a clear understanding of the transition process and the time frame involved.

With a timeline in place, it is possible to fine-tune your plan based on the level of involvement you wish to have in the company and the future you envision for your business. Because



it may have taken years or decades for you to build your company to its current level of success, your successor will most likely need time to get up to speed. To teach the next generation, many owners foster mentoring relationships that immerse successors in the day-to-day operations.

### *Valuating Your Business*

When you have a sense of direction for your business, it's time to develop the appropriate tax and financial strategies for both the short and long term. One important planning step will be valuating your business—essentially estimating the value of your company. There are many valuation methods, and depending on your situation, one technique may be more appropriate than another. We can help you through this complex process.

The common goal for business owners who are selling their businesses

is to reach a valuation that fairly compensates the owner for his or her interest, while making the price attractive to the potential buyer. Profit may be less of a concern for owners who are passing a business to children.

For income, estate, and gift tax purposes, the Internal Revenue Service (IRS) is interested in having the business fairly priced. This is especially important if a related party is at the other end of the transaction. When considering valuations, the IRS generally looks at the nature and history of the business, the economic outlook for the business's industry, how assets and earnings are being valued, the existence of intangible assets, and the selling price of comparable businesses using, if possible, industry formulas.

### *Consider Your Transfer Options*

Owners have a variety of options to transfer ownership, and the right strategy for you depends on your specific situation, considering factors such as your personal financial and tax situation, your business's current form of ownership (sole proprietorship, partnership, corporation, etc.), and the future owners (family, employees, third party, etc.).

There are succession tools and techniques that can help make passing the torch both financially rewarding and tax efficient. Some of the possibilities include selling the business outright, making gifts of business interest over time, establishing a family limited partnership (FLP), creating a trust, or transferring ownership to employees.

*continued on page four*

## understanding mutual fund “styles”

*continued from page one*

Morningstar places individual mutual funds into one of nine style boxes based on how the majority of the particular stocks held by the fund are categorized.

### *Size Adds Another Dimension*

Within each of these three broad categories a further distinction can be made based on company size. While definitions vary, **small cap** companies could be defined as those with a market capitalization (the current worth of all outstanding shares) under \$1 billion; **medium cap** companies, as those with a market capitalization between \$1 billion and \$5 billion; and **large cap** com-

panies, as those with over \$5 billion in market capitalization.

To illustrate the importance of company size, many smaller companies achieve rapid growth that tends to level off once a company becomes very large. Also, investing in smaller companies presents unique risks and levels of uncertainty that may or may not be tied to overall market performance.

### *More Than a Fashion Choice*

To return to the question posed at the outset, it's easier to see that using fund names could be misleading. Differentiating on the basis of style (including company size) can

fine-tune a mutual fund portfolio and help increase diversification.

Different investment styles tend to complement one another, adding a measure of diversification and, thus, potentially reducing portfolio risk. By introducing style analysis into the mutual fund evaluation process, individuals may be able to tailor fund selections to better reflect their investment personality. ■

*Note: Investment returns and principal values will change due to market conditions, and as a result, when shares are redeemed, they may be worth more or less than their original cost. Past performance is no guarantee of future results.*

## to be continued...the art of business succession planning

*continued from page three*

One planning tool for arranging the disposition of an owner's business interest is a buy-sell agreement. This is a contract between two or more parties, whereupon a triggering event such as death, disability, or retirement, one party has an obligation to *buy* an interest in the company while the other party has an obligation to *sell*. It obligates the owner's estate to sell his or her shares for a predetermined price to partners or shareholders (a cross-purchase agreement), to the business itself (an entity agreement), or to both (a hybrid agreement).

Although a buy-sell agreement can help ensure that your business will remain with your family or business partners, it is essential that sufficient funds are available to fulfill the commitments of the agreement. There are a variety of options for funding buy-sells, from employee stock ownership plans (ESOPs) to life insurance, and again, the best choice will depend on the parties involved.

Successful continuation is a challenge for small businesses. According to the Small Business

Administration (SBA, 2006), 70% of family-run businesses fail to survive in the second generation. Only 15% succeed into the third generation.

For scheduled departures such as retirement, a succession plan can help ensure smooth operations during the time of transition, as well as facilitate the transfer of ownership. In times of crisis, it can be the foundation for continued success. Call us for help securing your company's future with a business succession plan. ■

**The information provided is not written or intended as tax or legal advice and may not be relied on for purposes of avoiding any Federal tax penalties. Individuals are encouraged to seek advice from their own tax or legal counsel. Individuals involved in the estate planning process should work with an estate planning team, including their own personal legal or tax counsel.**