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# Innovative ALTERNATIVE STRATEGIES

HOW ADVISORS CAN ACHIEVE PORTFOLIO DIVERSIFICATION AND ALPHA

## Achieving Tax Efficiency with Alternatives

### MODERATOR

**Steven H. Solys**

Managing Director

*Legacy Private Capital, LLC*

### PANELISTS

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National Accounts

*Sterling Trust*

**Kevin Sullivan**

Senior Vice President and Director of National Sales

*Jefferson National*

# Why Invest in Domestic Energy?

Alternative Energy (renewable) collectively only provides about 7% of world energy.  
In 1949 Petroleum accounted for 37.1% of US total energy and 36.7% in 2010.

Source: US EIA

- **Oil Prices are being driven by global demand vs. supply.**  
*Note: Since 2006 global oil production has steadily averaged 72M b/d while demand has steadily risen from 85M b/d to 89M b/d. The difference has been made up with NGL's (i.e. "wet gases"). Source: U.S. EIA*
- **Turn an income tax liability into an asset without stock market exposure or volatility.**  
*Fact: Merrill Lynch, Jan. 2010 "Energy is currently our preferred play on emerging economy driven global growth and compared to Materials is at lesser risk if the pace of growth slows down."*
- **Tax Benefits: Intangible Drilling Cost (IDC) Tax Deduction-** can offset personal income from other sources. Average Oil & Gas Drilling Program has an 85% IDC

## Annual Oil Consumption Per Person:

USA 25, Japan 14, W.Euro 11,  
Mexico 7, China 2.1, India 0.9

(Source: CIA World Fact Book)



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# Tax Form – 1040

Form **1040** Department of the Treasury—Internal Revenue Service  
**U.S. Individual Income Tax Return 2008** (99) (IRS Use Only—Do not write or staple in this space.)  
 OMB No. 1545-0047

**Label** (See instructions on page 14.) Use the IRS label. Otherwise, please print or type.

For the year Jan. 1-Dec. 31, 2008, or other tax year beginning 2008, ending 2008

Your first name and initial Last name  
 If a joint return, spouse's first name and initial Last name  
 Home address (number and street), if you have a P.O. box, see page 14. Apt. no.  
 City, town or post office, state, and ZIP code. If you have a foreign address, see page 14.

Your social security number  
 Spouse's social security number

▲ You must enter your SSN(s) above. ▲  
 Checking a box below will not change your tax or refund.

Presidential Election Campaign  Check here if you, or your spouse if filing jointly, want \$3 to go to this fund (see page 14)  You  Spouse

**Filing Status**  
 1  Single  
 2  Married filing jointly (even if only one had income)  
 3  Married filing separately. Enter spouse's SSN above and full name here. ▶  
 4  Head of household (with qualifying person). (See page 15.) If the qualifying person is a child but not your dependent, enter this child's name here ▶  
 5  Qualifying widow(er) with dependent child (see page 16)

**Exemptions**  
 6a  Yourself. If someone can claim you as a dependent, do not check box 6a.  
 b  Spouse  
 c **Dependents:**  
 (1) First name Last name (2) Dependent's social security number (3) Dependent's relationship to you (4) If married, child for child tax credit (see page 17)  
 If more than four dependents, see page 17.  
 d Total number of exemptions claimed

**Income**  
 Attach Form(s) W-2 here. Also attach Forms W-2G and 1099-R if tax was withheld.  
 If you did not get a W-2, see page 21.  
 Enclose, but do not attach, any payment. Also, please use Form 1040-V.

7	Wages, salaries, tips, etc. Attach Form(s) W-2	7
8a	Taxable interest. Attach Schedule B if required	8a
b	Tax-exempt interest. Do not include on line 8a	8b
9a	Ordinary dividends. Attach Schedule B if required	9a
b	Qualified dividends (see page 21)	9b
10	Taxable refunds, credits, or offsets of state and local income taxes (see page 22)	10
11	Alimony received	11
12	Business income or (loss). Attach Schedule C or C-EZ	12
13	Capital gain or (loss). Attach Schedule D if required. If not required, check here ▶	13
14	Other gains or (losses). Attach Form 4797	14
15a	IRA distributions	15a
b	Taxable amount (see page 23)	15b
16a	Positive and negative	16a
b	Taxable amount (see page 24)	16b
17	Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E	17
18	Form income or (loss). Attach Schedule F	18
19	Unemployment compensation	19
20a	Social security benefits	20a
b	Taxable amount (see page 25)	20b
21	Other income. List type and amount (see page 28)	21
22	Add the amounts in the far right column for lines 7 through 21. This is your total income ▶	22
23	Educator expenses (see page 28)	23
24	Certain business expenses of reservists, performing artists, and fee-basis government officials. Attach Form 2106 or 2106-EZ	24
25	Health savings account deduction. Attach Form 8889	25
26	Moving expenses. Attach Form 3903	26
27	One-half of self-employment tax. Attach Schedule SE	27
28	Self-employed SEP, SIMPLE, and qualified plans	28
29	Self-employed health insurance deduction (see page 29)	29
30	Penalty on early withdrawal of savings	30
31a	Alimony paid b Recipient's SSN ▶	31a
32	IRA deduction (see page 30)	32
33	Student loan interest deduction (see page 33)	33
34	Tuition and fees deduction. Attach Form 8917	34
35	Domestic production activities deduction. Attach Form 8803	35
36	Add lines 23 through 31a and 32 through 35	36
37	Subtract line 36 from line 22. This is your adjusted gross income ▶	37

For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see page 88. Cat. No. 113208B Form **1040** (2008)



# Tax Form – Schedule E

## Example of \$100,000 Investment

Schedule E (Form 1040) 2008 Attachment Sequence No. **13** Page **2**  
 Names shown on return. Do not enter name and social security number if shown on other side. Your social security number

**Caution.** The IRS compares amounts reported on your tax return with amounts shown on Schedule(s) K-1.

**Part II Income or Loss From Partnerships and S Corporations** Note. If you report a loss from an at-risk activity for which any amount is not at risk, you must check the box in column (e) on line 28 and attach Form 6198. See page E-1.

**27** Are you reporting any loss not allowed in a prior year due to the at-risk or basis limitations, a prior year unallowed loss from a passive activity (if that loss was not reported on Form 8582), or unreimbursed partnership expenses?  Yes  No  
 If you answered "Yes," see page E-7 before completing this section.

	(a) Name	(b) Enter P for partnership, S for S corporation	(c) Check if foreign partnership	(d) Employer identification number	(e) Check if any amount is not at risk
A	Partnership Name	P	<input type="checkbox"/>		<input type="checkbox"/>
B			<input type="checkbox"/>		<input type="checkbox"/>
C			<input type="checkbox"/>		<input type="checkbox"/>
D			<input type="checkbox"/>		<input type="checkbox"/>

Passive Income and Loss		Nonpassive Income and Loss	
(f) Passive loss allowed (attach Form 8582 if required)	(g) Passive income from Schedule K-1	(h) Nonpassive loss from Schedule K-1	(i) Section 179 expense deduction from Form 4562
A		90% of Amount Invested	
B			
C			
D			
<b>29a Totals</b>			
<b>b Totals</b>			
<b>30</b>	Add columns (g) and (i) of line 29a		<b>30</b>
<b>31</b>	Add columns (h), (i), and (j) of line 29a		<b>31</b> ( \$90,000 )
<b>32</b>	<b>Total partnership and S corporation income or (loss).</b> Combine lines 30 and 31. Enter the result here and include in the total on line 41 below.		<b>32</b> ( \$90,000 )

**Part III Income or Loss From Estates and Trusts**

	(a) Name	(b) Employer identification number
A		
B		

Passive Income and Loss		Nonpassive Income and Loss	
(c) Passive deduction or loss allowed (attach Form 9582 if required)	(d) Passive income from Schedule K-1	(e) Deduction or loss from Schedule K-1	(f) Other income from Schedule K-1
A			
B			
<b>34a Totals</b>			
<b>b Totals</b>			
<b>35</b>	Add columns (d) and (f) of line 34a		<b>35</b>
<b>36</b>	Add columns (c) and (e) of line 34a		<b>36</b> ( )
<b>37</b>	<b>Total estate and trust income or (loss).</b> Combine lines 35 and 36. Enter the result here and include in the total on line 41 below.		<b>37</b>

**Part IV Income or Loss From Real Estate Mortgage Investment Conduits (REMICs) – Residual Holder**

	(a) Name	(b) Employer identification number	(c) Excess inclusion from Schedules O, line 2c (see page E-7)	(d) Taxable income (net loss) from Schedules O, line 1b	(e) Income from Schedules O, line 3b
<b>38</b>					
<b>39</b>	Combine columns (d) and (e) only. Enter the result here and include in the total on line 41 below				<b>39</b>

**Part V Summary**

<b>40</b>	Net farm rental income or (loss) from Form 4835. Also, complete line 42 below	<b>40</b>
<b>41</b>	<b>Total income or (loss).</b> Combine lines 26, 32, 37, 39, and 40. Enter the result here and on Form 1040, line 17, or Form 1040NR, line 18	<b>41</b>
<b>42</b>	<b>Reconciliation of farming and fishing income.</b> Enter your gross farming and fishing income reported on Form 4835, line 7; Schedule K-1 (Form 1065), box 14, code B; Schedule K-1 (Form 1120S), box 17, code T; and Schedule K-1 (Form 1041), line 14, code F (see page E-8)	<b>42</b>
<b>43</b>	<b>Reconciliation for real estate professionals.</b> If you were a real estate professional (see page E-2), enter the net income or (loss) you reported anywhere on Form 1040 or Form 1040NR from all rental real estate activities in which you materially participated under the passive activity loss rules	<b>43</b>

Schedule E (Form 1040) 2008



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# Ideas for Reasonable Investing

- Focus on risk reduction balanced against yield.
- Try to stick with programs which involve drilling (this potentially maximizes accepted tax benefits) and generally stay away from the more complex areas of the oil & gas business.  
(ie. Dewatering of coal bed methane, deep shale plays with yet undetermined economic stability, offshore drilling, and programs depending on commodity hedging to be profitable.)
- Royalty investments and purchases of existing production have minimal cash tax benefits.
- Be careful of programs that tout “yield” when they are really giving you return of principal. Pick a program that can possibly maximize your tax benefits while creating a potential for return of principal and yield over a relatively short period of time without increasing your drilling/finding risk.
- Work through BD’s that are associated with sponsors who have years of knowledge in the oil and gas business.
- Use common sense and stick with simple programs that work at lower oil and gas prices.
- Avoid programs with high “loads” (upfront cash, carried working interest, etc.)



\*Note: Comments on this page have been made by various industry professionals.

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# Welcome to Sterling Trust

We specialize in the custody of alternative investments within IRA accounts – providing a strategy for businesses and individuals to diversify beyond traditional investment products.

*As a passive custodian, we don't provide tax, legal, or investment advice, nor do we sponsor or sell investments.*

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# The Sterling Trust Difference

## Financial position, strength and longevity

- \$11 billion in assets
- Un-invested cash in FDIC insured accounts
- 129,000 accounts
- State Bank/trust charter
- Qualified IRA custodian
- Founded in 1974

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# Benefits of working with us

## 30 plus years of experience

Variety of educational options:

- Case studies
- Webinars
- White Papers/reports/guides
- Membership to the Professional Network

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# Allowable Investments

- Private stock offerings, private placements
- Private limited partnerships, limited liability companies, and C corporations
- Hedge funds
- Promissory notes/private debt
- Foreign currencies trading accounts or FOREX
- Managed futures
- Gold, silver, platinum and palladium bullion which meet minimum fineness requirements
- Residential and commercial real estate/ raw land
- Real estate notes (mortgages and deeds of trusts)
- Tax lien certificates
- Oil and gas investments
- Auto finance notes
- Equipment leasing
- Publicly traded stocks, bonds, mutual funds
- Factoring investments
- Accounts receivable
- Judgments/structured settlements
- Much more as investors continue to find areas where they have expertise

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# Unique Examples

Tree Farms

Horses

Oil and Gas wells

Golf Courses

Theater/Movie Production companies

Promissory Note lending

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# Market Dynamics

- Advisors responding to volatile markets by turning to alternatives and tactical strategies to manage risk in portfolios
  - 68% of advisors are feeling pressure to revisit their asset management strategy
  - 68% using more alternatives; 63% more likely to use tactical strategies
  - 61.5% claim alternatives will become more important than traditional investments
- Creation and use of alternative products trending upward
  - 70 alternative funds launched in 2011
  - 2011: Alternatives inflows of \$23.2 Billion vs. US Equities lost \$84.7 Billion
  - McKinsey & Co report:
    - Predicts that by 2015 retail alternatives will account for 13% of retail fund assets
    - Nearly doubling from 7% in 2010
  - Client interest and acceptance on the rise
- Taxes likely to increase – especially for High Net Worth
  - Health Care - 3.8% tax
  - Bush Tax cuts

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# Tax Efficiency

- Alternative and tactical strategies often have tax implications
- Research with University of Chicago
  - Tax deferral can increase returns by as much as 100bps
  - 35+ years of Morningstar data and 80+ years of Ibbotson data
  - REITs, commodities, alternatives and tactical strategies perform better in tax-deferred vehicle
- Morningstar Tax Cost Ratio
  - Measures how taxable distributions can reduce a fund's annual return
- Benefits of tax efficiency and subsequent asset location decisions:
  - Offset inefficiencies of certain strategies
  - Increase after-tax returns and future income streams for your clients

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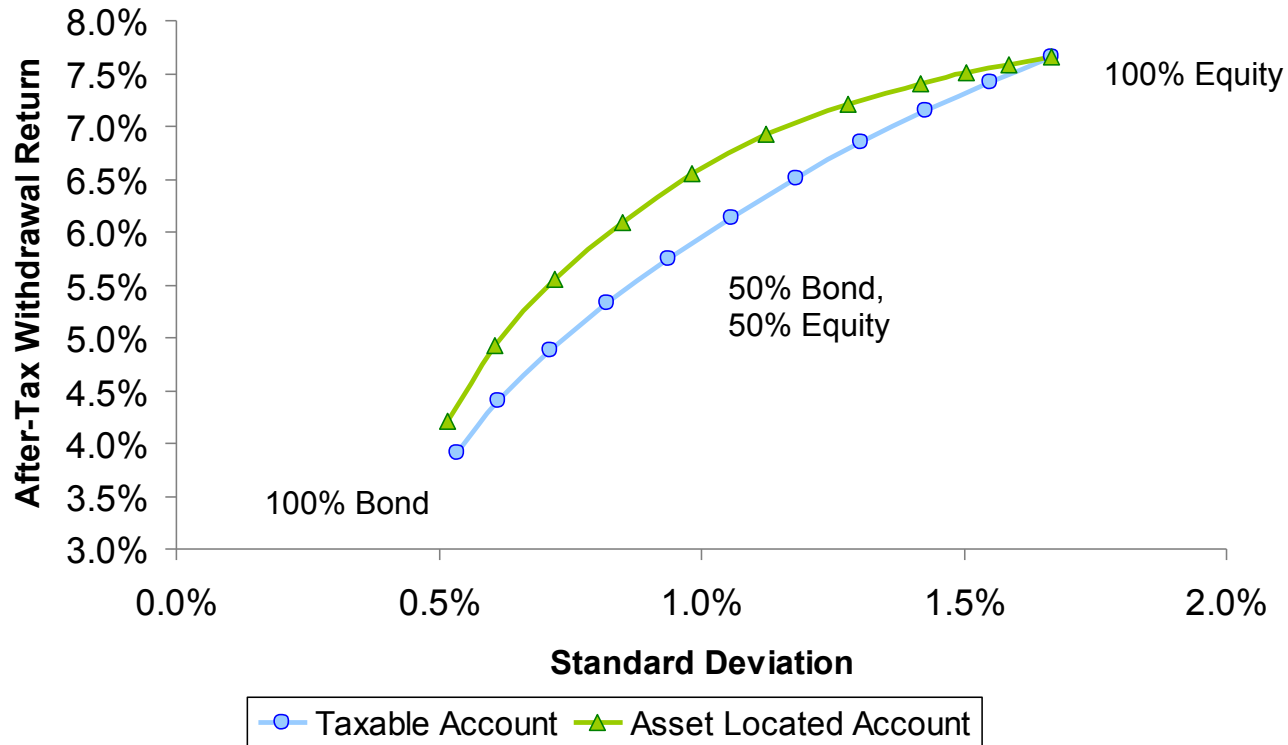
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# Tax Efficient Frontier

Two Fund 10-Year Efficient Frontier  
U.S. Stock Index Fund and Taxable Bond Index Fund \*



\*Based on return data from the CRSP Mutual Fund database, calculated for the highest Federal tax bracket. Average state taxes are also included. The 10-year returns are calculated for each 10 year period starting since the fund's inception in 1993 through 1998.

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# Implementation

- Know Options: Benefits and detractions of each
  - 401(k)
  - IRAs – Traditional and Roth
  - Variable Annuities
  - Others
- Tailor knowledge to clients' situation
  - Current income
  - Net worth
  - Liquidity needs
  - Financial plan

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