

Pulled In Two Directions

By: Patrick Bobbins, CFA®, CIMA®

April 2026

Typically, when we write these newsletters we focus on one topic. Today, I'll provide a bonus two-topic edition. Somewhat fittingly, both sections share the same underlying theme but from two different angles. We will cover inherited irrevocable trusts along with a brief update on the Federal Reserve and recent market volatility.

I'll lead with the financial planning topic, which is related to inheriting assets in a trust. We deal with many clients who are either looking to create a trust to facilitate the transfer of assets to their heirs or have inherited assets inside of the trust structure. I'd like to discuss a more nuanced idea of when to dissolve that trust structure and relocate the assets.

Let's assume that you inherit a trust from your parents or a relative. The trust you receive is irrevocable, but you are the trustee and the beneficiary of the trust assets. Currently, this trust is treated as its own tax entity and files its own separate tax return each year. This trust is also taxed within the "Trust and Estate Brackets," where the 37% marginal bracket kicks in at \$16,000 of income or capital gains. In short, a trust can be subject to significantly higher taxes if income is retained rather than distributed to you.

It's also worth reviewing the trust itself since many inherited trusts are written quite simply. Your parent's or relative's intent is typically for these funds to be used for your enjoyment, education, healthcare, and overall well-being with both income and principal available for distribution to you as the beneficiary. While other rules or age limitations may apply, this type of language is pretty common.

There are a few things that jump out to us in this situation:

1. Make sure to review distributing out the income each year to avoid potentially very high tax brackets. You have 65 days from yearend to distribute this income so that it will be taxed toward your personal bracket instead of the trust's.
2. The second, in my opinion, is more important. Look to distribute out the trust assets to your personal investment account and or a new revocable trust you create. While you may give up some protection against creditors in this situation, if there isn't a risk of bankruptcy, that distribution may be worth



considering. With this scenario there would be no need to keep up and file taxes on the trust or jump through hoops to distribute out the income each year to limit taxes.

3. Let us help review what makes sense for your situation. We've recently evaluated several trusts facing similar circumstances. We were able to successfully dissolve the trust, transfer the assets to a new revocable trust or individual account and save on taxes. In one case, we were able to facilitate a substantial charitable contribution that would not have been possible within the inherited trust structure.

If this trust topic is confusing to you, that is very normal. It can also feel that you may be emotionally pulled in different directions. This is completely normal as trusts are often tied to family legacy and long held intentions. Our goal is to help you honor those wishes while simplifying your financial life.

The second topic relates to the recent market events and the Federal Reserve. We've seen increased stock market volatility surrounding the military actions in the Middle East, oil prices have risen and with that the possibility of inflation jumping higher than expected. Over the past several quarters, we've highlighted how the Federal Reserve has been pulled in different directions. One mandate focuses on full employment while the other centers on price stability. The recent rise in oil prices and increased market volatility have made the Federal Reserve's job even more challenging this year. While unemployment remains relatively stable, prolonged elevated oil prices increase the risk that inflation begins to rise as well. With these inflation pressures building, we do not foresee the Federal Reserve cutting interest rates significantly.

During these turbulent times in the market, it can feel that control is lost. Honestly, we were never able to control interest rates, the stock market, geopolitical events, etc. Through these hard times it is important to remember to focus on what we can control.

Three things jump out here:

1. We can control distributions and tax strategies. You can control where you pull funds from, what IRA dollars get converted to Roth dollars and what bonds we own to produce income. A focus on tax strategies and distribution planning is always within our control.
2. We can control the overall risk in the investment portfolio. Often nervous calls we receive are from clients who don't have much exposure to the stock market. It is our job to determine what level of risk is needed to achieve your



goals. If a limited amount of risk is needed to make the plan work, then these volatile times shouldn't keep you up at night.

3. Focus on the time horizon of your money. In most cases, the portion of bonds or safer funds in the portfolio more than supports the distribution needs for many years ahead. This shorter-term money acts as the ballast, is designed to produce income and likely gets spent first. The stocks or riskier funds in the portfolio were likely never meant to be spent during this calendar year. Moves up and down in stock market will always occur. Know going in that these dollars are for your spending 5, 10 or 20 years into the future. History shows that over a 5- or 10-year period, stocks usually are higher than they are today. It's OK to experience a -5% or -10% drop. Remember that the historical average is a -14% peak-to-trough drop in one calendar year. Risk is normal so focus on what you're spending today and how much you own of lower-risk. We are here to help reframe that focus if any of the recent market events are keeping you up at night.

As always, we're here to support you. If you have questions or would like to talk through your situation, please reach out. Also, please keep us in mind if you have friends or family who may benefit from our services. We would love to get connected with them.

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