The
FINANCIAL UPDATE

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FEE-ONLY FINANCIAL PLANNING

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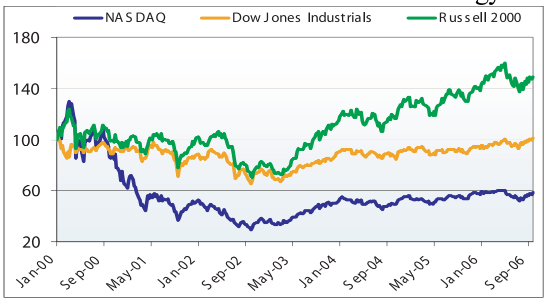
Dow Breaks All-Time High But It May Be Misleading

When the Dow hit a new high, at long last surpassing the record it set in January 2000, the event was more than a reason for investors to celebrate. The early October breakthrough also served as a reminder that the stock market is more than the Dow Jones Industrials or the Standard & Poor's 500. The overall market is made up of thousands of individual stocks, each one providing investors the opportunity to evaluate a company's stock price against its prospects.

In hindsight, many stocks in the Dow Jones Industrial Average on the record-setting day of January 14, 2000, were wildly overpriced. By the Fall of 2006, when the Dow Jones made its new high, 20 of the 30 Dow stocks remained in negative territory compared with their prices almost seven years earlier. Some were not even close to regaining the ground they had lost. For example, Microsoft and Intel are still down 50% and 60%, respectively.



Dow hits new high long after Russell 2000.

Meanwhile, other indices, gauging the progress of other kinds of stocks, have done much better. Though the milestone received little notice, the Russell 2000 index of small company stocks surpassed its 2000 peak in 2004, and it now trades about 25% above its 2000 high.

With growth stocks, particularly those of technology companies, heading for the stratosphere in 1999 and 2000, bargain stocks with more traditional "value" characteristics trailed significantly. Since then, though, value has outpaced growth. The Dow Jones Small Cap Value index gained 13% annually (excluding dividends) from December 1999 through September 2006. So while the Dow Industrials were merely recovering lost ground, small cap value stocks more than doubled.

The Dow Jones Large Cap Value index didn't fair nearly as well—most large caps were richly priced in 1999 and 2000—but even that benchmark beat the Dow with an annualized gain of 3% during the same 81 months ending in September 2006.

Some industry sectors also weathered the shakeout far better than the Dow Industrials. Energy stocks were hardly a hot sector in early 2000. But since the beginning of that year, Morgan Stanley's energy index has appreciated at a 10% compound annual rate, and is up a cumulative 91%. Morgan Stanley's Consumer Staple index managed a 3% annual gain, for a total increase of 22% during that period, also outperf-orming the flat-lining Dow.

Compare the performance of those indices to the Morgan Stanley Information Technology index, which lost 58% during the 81 months from December 1999 through September 2006. That's a 12% annualized loss. The tech-laden Nasdaq Composite, too, has suffered famously, trading recently at less than half its all-time high.

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We're All Living And Investing In A Global World

Thanks in large part to technology, the global economy is now more tightly integrated than it has ever been before. Products and, increasingly, services crisscross the world on the way to their ultimate consumers. China's spectacular industrialization drives aluminum prices in New York, wages in Delhi affect the job market in Dublin, and the price of oil drives everything.

This interconnected world requires new levels of sophistication from all of us, especially when it comes to investing. As international factors play a larger role in the economic realities of even the most U.S. focused companies, the line between "foreign" and "domestic" markets blurs. Even in a traditionally location-dependent sector like real estate, apartment prices in Tokyo and New York (or Latin America and Miami) are now linked by the same parameters of supply and demand. And while many people think they live, work, and play in the United States, they're still competing with an entire world of consumers for jobs, raw materials, and every kind of value-added commodity from drinking water to investment advice.

It's true that investing in foreign securities carries political and currency risk. But what's also true is that investing in U.S. securities is increasingly affected by global political and currency risks. To some degree, we're all global investors.

We're aware of the growing influence of foreign economies on U.S. investments and how foreign securities can diversify a portfolio. We just want to be sure you are, too.

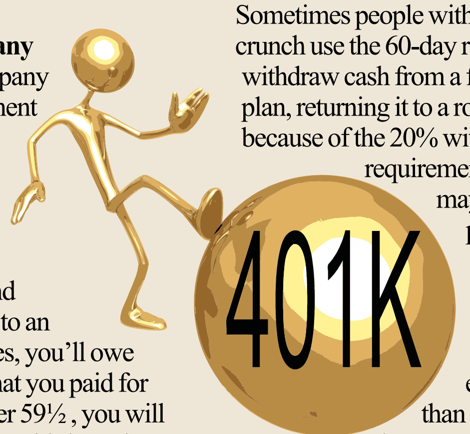
John R. Day

Avoiding Mistakes On IRA Rollovers

When you change jobs, you can make a tax-free rollover of your 401(k) to an IRA. Often, that's a good idea. IRAs generally offer broader investment choices than you get in a 401(k). Moreover, if you switch jobs several times during your career, your retirement savings will be easier to manage if you consolidate the money in one place.

Yet while a rollover often makes sense, rules governing such transfers are complicated and unyielding. Make a mistake and you could pay penalties and taxes and negate the benefits of moving to the IRA in the first place. Consider these pitfalls:

Failing to do a direct rollover. It's your last week at work, and when your personnel department asks what to do with your 401(k) balance, you request a check. As long as you redeposit the account's full value in an IRA within 60 days, you won't owe income tax or a 10% penalty for withdrawing retirement money before age 59½. (If you're at least 55 when you leave your job, you can keep the money without penalty.) However, your employer must withhold 20% on the amount of your check—and if you have, say, $500,000 in your 401(k), that means your check will be for just $400,000. Yet to avoid taxes and penalties, you'll have to deposit the full $500,000 in your rollover IRA. Where will the extra money come from? Unless you have that much sitting in a bank account, you may have to sell investments in a taxable account to raise the cash, and that could generate capital gains taxes. Assuming you do meet the 60-day deadline, you'll eventually get back much of the $100,000 your employer withheld, but not until the following year, after you've filed your federal taxes. (Whether you get the full amount depends on your overall tax situation for the year.) A better way: You could direct your company plan to roll over the money directly to your IRA and avoid this problem.



Rolling over company stock. Stock in your company that's held in your retirement plan is often eligible for special treatment when you leave a job. So moving the shares to a taxable account may be better than cashing out and rolling over the proceeds to an IRA. If you take the shares, you'll owe regular income tax on what you paid for them. And if you are under 59½ , you will also owe a 10% IRS early-withdrawal penalty. Assuming you are over 59½, in the 35% tax bracket, and that your original cost for the stock was $100,000, you'll owe $35,000 if you withdraw the shares and place them in a taxable account. But suppose the shares are now worth $200,000. That, as well as any further appreciation, could be taxed at the more favorable long-term capital gains rate of 15%—and only after you sell the stock. So your tax on the appreciation would be just $15,000. And if you never sell, your heirs get a step-up in basis on any appreciation in the stock that occurred after the transfer to the taxable account. If you roll over your shares to an IRA, however, their full value will eventually be taxed as income. So your total bill on the IRA withdrawal, again assuming a 35% rate, would be $70,000 instead of $50,000.

Borrowing from the wrong account. Sometimes people with a temporary cash crunch use the 60-day rollover window to withdraw cash from a former employer's plan, returning it to a rollover IRA. Yet because of the 20% withholding requirement, this strategy may only exacerbate problems. A better idea is to take the money from a rollover IRA you've already established (rather than a 401(k)). Here, too, you have 60 days to return the money without penalty, but there's no withholding. You're allowed to make such a transaction once a year.

In these and many other rollover-related transactions—including, for example, the nightmare scenario of splitting a rollover in a divorce settlement—it's all too easy to get it wrong. If you're considering a rollover, we can help you avoid mistakes and chart a course that fits your financial situation. ●

When Your Financial Advisor Accepts The Role Of Fiduciary,

In the world of financial advisors there are myriad labels, certifications, registrations, and other terms that tend to be meaningful only to industry insiders. But one distinction could be crucial: An advisor bound by contract or law to serve as a "fiduciary" is obligated to act solely in your best interest. That's different from others who may seem to work for you but in fact owe primary allegiance to the companies that pay them.

With other professionals, such as lawyers and CPAs, there's typically a fiduciary responsibility that requires them to act in clients' best interests. But for financial advisors, fiduciary status is not yet standardized or guaranteed. So while you may think your stockbroker offers unbiased advice, he or she is probably receiving a commission for selling you products. To complicate matters, even a fee-based advisor who charges for advice may not be acting solely in your interest.

Not surprisingly, there's widespread confusion among consumers on this point. According to a recent survey by a major financial services firm:

- More than half of the investors interviewed believed both stockbrokers and Registered Investment Advisors (RIAs) have an obligation to act in the client's best interests.
- Three out of four investors didn't realize that only independent RIAs have a fiduciary duty to their clients.

RIAs must inform clients of potential conflicts of interest, and they're legally obligated to act as a fiduciary. They have a fiduciary duty to act in their clients' interest at all times. Stockbrokers don't have the same obligation. Brokers must make recommendations that are suitable but are not required to adhere to the higher standard of care— to always do what's in your best interest—as a fiduciary.

Coordinating A Couple's Retirement Plans

Back in the days of Ozzie and Harriet, retirement decisions were simple: the husband's retirement plans were the couple's retirement plans. Today, you and your spouse may both work, and retirement timing and coordination is a challenge. While leaving the work force at more or less the same time may seem ideal, issues of age, health, job satisfaction, and pension and other employment benefits can make that tough to pull off.

For most couples, joint retirement decisions mean weighing the benefits of having more leisure time to spend with each other against the cost of one or both of you leaving work. That can be difficult to gauge, particularly when spouses are different ages, work for different employers, and face conflicting retirement incentives. Richard W. Johnson, a researcher for the Center for Retirement Research at Boston College, cites the example of a couple in which the husband has a company-sponsored retirement plan that lets him retire at age 62. His wife is three years younger, and the retirement age in her employer's plan is 65. For the husband, retiring at 62 may be financially beneficial. Yet by the same token, if the wife waits until her financially optimum retirement date, she could end up working six years longer than her husband, giving away a substantial portion of the time they could have spent together during retirement.

Health insurance coverage may be another sticking point, particularly when one or both spouses is thinking about retiring before age 65, when Medicare coverage begins. For example, consider what would happen if our couple went ahead and retired when he was 62 and she was 59. Assuming both had health coverage at work but neither had retiree health benefits—an increasingly common situation, according to Johnson—for three years, until the husband reached Medicare age, they would both need to buy private, non-group insurance. That tends to be prohibitively expensive, and she would continue to need coverage for an additional three years after her husband qualified for Medicare. They would be much better off financially if she kept her job and benefits.

There are also questions of job satisfaction and health. Many people today choose to keep working past normal retirement age, at least in part because they enjoy what they do. Yet when both spouses have jobs, one may love going to work every day while the other is counting the days until retirement. Meanwhile, health problems may force the issue, pushing a spouse into retirement regardless of financial consequences.

Still, despite all of these issues, in about half of all couples, both spouses manage to retire within two years of each other, according to Johnson's calculations, and for two-thirds of couples, it happens within four years. Give us a call if you and your spouse would like to review your retirement plans and make sure you're on track to retire on your own terms. ●

You Have A Foundation For Trust

The distinction between an advisor who is a fiduciary and one who is not could be critical when weighing an advisor's recommendations. There may be a hidden agenda—for example, if an advisor is receiving better commissions for selling you one mutual fund instead of another.

Rules recently clarified by the Securities & Exchange Commission permit brokers to give you investment advice on a fee basis and not act as a fiduciary. In these instances, a broker can only give you advice about one or two issues—such as your retirement plan or investing. If a broker wishes to give you comprehensive financial advice that spans insurance, taxation, college planning and estate planning as well as investing and retirement planning, the broker must accept his or her role as a fiduciary to you. He must disclose that he will begin giving you advice as a fiduciary and then tell you when he has stopped acting as a fiduciary and reverted back to his role as your stockbroker.

Working with someone who is a fiduciary, or will sign an agreement to act as a fiduciary, doesn't guarantee you'll profit from the advisor's recommendations. But it does give you a greater assurance that you're both sitting on the same side of the table.●

High Income? Forget About College Aid

Still hoping your child will qualify for college financial aid? It may be time to throw in the towel.

A recent report from TIAA-CREF, the big retirement plan provider and asset manager, is supposed to have good news for parents. According to the report, family savings reduce the chance of aid less than many have suspected, particularly when assets are held in the parents' name in a 529 plan, Coverdell Education Savings Account, or taxable investment account. But the report also concludes that the children of parents with high incomes and substantial wealth are unlikely to get any help with education costs.

The price tag for college continues to rise far more quickly than the overall inflation rate. According to the College Board, total expenses at a public university for the 2004-2005 school year averaged $11,354, 10.5% higher than a year earlier. At private colleges, the average price tag was $27,516, 6% above the previous academic year. But many top schools charge even more. Duke University, for example, now suggests that families budget $44,000 for an undergraduate year.

All colleges, public and private, use complex formulas to determine a student's financial need. By gauging parental and student income and assets, the institutions come up with a figure known as the Estimated Family Contribution, or EFC. That's the amount you're expected to pay. If a school's costs are higher, financial aid—primarily loans, in many cases—could make up the difference.

The TIAA-CREF report points out that commonly quoted yardsticks for calculating the EFC may overstate the actual impact on a family's finances. The rules of thumb are that 35% of the student's assets and 5.64% of parents' holdings must be used. In fact, says the report, most parents pay much less. However, high-income families are likely to be asked to shoulder the entire cost of college.

Consider three families. The first has a pre-tax income of $50,000 a year. If the family has $60,000 in net assets, excluding the value of its home and retirement accounts, its EFC is $0. With $100,000 in assets, it should pay $30, and with $200,000, its EFC is $2,674, according to the TIAA-CREF calculations.

The second family makes $100,000 a year. At the same three asset levels—$60,000, $100,000, and $200,000—this family's EFC would be $7,694, $9,950, and $15,590, respectively.

And family 3? With an annual income of $200,000 and net assets of $60,000, its EFC is $34,421. With $100,000 in assets, it is expected to pay $36,677, and with assets of $200,000—again, not including what its home or retirement plans are worth—its EFC is $42,317.

The TIAA-CREF report emphasizes that for families hoping to receive aid, where they save for college makes a big difference, with parent-controlled accounts far preferable to custodial accounts in a student's name. Some financial aid experts have even suggested families consider depleting custodial accounts while increasing savings in a 529 plan or Coverdell account. But wealthier families needn't worry about where to keep college savings, because they're less likely to qualify for aid in any case. ●

Dow Breaks All-Time

(Continued from page 1)

What should investors make of the widely varying performance of various stock market sectors and indices? Most obvious, of course, is the peril of ignoring diversification, a point driven home by the devastation wreaked upon tech and telecom stocks since 2000. But effective diversification may require more than simply owning a fund tracking a broad stock index. For example, investors in 2000 who held an S&P 500 index fund may have assumed they were investing in a widely diversified equity portfolio. Yet at the time, much of the value of the S&P was in a few mega-cap stocks, then selling at record-high valuations and soon to come plunging back to earth.

Discretion, in addition to diversification, can help investors weather the next stock market storm. Those who understood that even the S&P 500 was more than a little frothy seven years ago—and who resisted the lure of other faddish investments—may have suffered in the short term but have been well rewarded as the markets have straightened themselves out, with the prices of most stocks now once again bearing some relation to underlying fundamentals.

Recognizing an investor's risk tolerance and structuring a portfolio that takes into account that highly personal variable is also helpful. Those who are conservative, either by temperament or because of their financial situation, may need to be particularly careful to stay away from market manias—and to diversify well beyond even such seemingly solid benchmarks as the Dow Industrials, whose slow recovery was all the more painful for those who needed to tap their investments during the interim.

While the Nasdaq was decimated by the demise of many outlandish stocks, the Dow was dragged down by some of the bluest of blue chips. Wal-Mart, Verizon, Hewlett-Packard, and Coke all fell by double-digits, not because their survival was in question, but because their rich valuations left them nowhere to go but down. It's our job to help you stay diversified and avoid vastly overvalued stocks and sectors while keeping the focus where it should be: on fulfilling your financial plan. ●

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