the Investment ADVISOR

First Quarter 2003

Welcome to 2003!

The start of a new year is always a good time for a little financial housecleaning. To get you underway, we've made a list of suggested ways you can start the year off right.

1. Update your list of investments and valuables.

If something happened to you tomorrow, would your family be able to find records of your insurance coverage, investment accounts, property titles, safe deposit boxes, cash stashes, and more?

2. Check your will.

Once made, wills are all too often forgotten. Read your will once a year to see that heirs are properly identified and bequests are as you would like them. Don't forget to also update beneficiaries on insurance and retirement accounts as needed.

3. Update Personal Property Appraisals

If you own valuable personal property, such as collectibles, fine art, jewelry and furs that tend to increase in value over time, you want to have a current appraisal of the value of those items for insurance purposes. To find a qualified appraiser, ask for references from museums and art dealers. You might also check with the two major professional associations — the American Society of Appraisers (ASA) and the Appraisers Association of America (AAA). Both have websites that allow you to search for organization members in your area.

4. Check your credit reports.

Make certain that the credit information on the report is truly yours. Under federal law, you are entitled to a free credit report within 60 days of being denied credit, employment, insurance, or rental housing based on information in a credit report. You can also receive a free report once a year upon request when you certify you: are unemployed and seeking employment; are receiving public welfare assistance; or believe your credit file contains inaccuracies resulting from fraud. Residents of Colorado, Maryland, Massachusetts, New Jersey, or

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Patience is the Watchword of Successful Investing

Read the popular media and it's easy to believe the bear market is over and stocks are headed back to their prior heights. The S&P 500 Index doesn't creep up; it surges, soars and rebounds enthusiastically. As for the declining days, investors shouldn't worry; it was merely a little profit taking according to the financial pundits. The truth of the matter is there are still reasons for healthy skepticism. A little patience is very much in order.

There are Bear Markets, and There are Bear Markets

To understand where we are today, technical analysis looks back at prior market cycles to establish patterns. While history may not repeat itself, it tends to rhyme. A similarity or symmetry tends to occur from market cycle to cycle. The longer the time periods, the more analysis tends to detect cycles within cycles. This leads

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Pension Plan Perils

As if investors didn't have enough to worry about, it turns out that bizarre accounting rules are allowing companies to report profits based on fictional gains of under-funded pension plans. According to a recent study by Credit Suisse First Boston, the 360 companies with defined benefit plans in the Standard & Poor's 500 Index are under-funded by about $243 billion. Morgan Stanley estimates the figure at $300 billion.

In 2001, companies reported a gain of $104 billion from their pension funds, when they actually saw pension fund assets go down by $90 billion. The gains were based on their pension fund consultants' estimates of earnings in coming years. If estimated earnings are more than needed to cover future estimated liabilities, the positive balance goes on the company's balance sheet. According to a study of the 100 largest companies with defined benefit plans, the companies estimate they are going to earn 9% or more on their pension fund investments in the near future.

But don't worry if they fail to do so, or head into bankruptcy. Pension plans are guaranteed by the Pension Benefit Guaranty Corp., an agency of the federal government. PBGC guarantees pension benefits up to a $42,954 per year for a 65-year-old worker retiring this year. As of June 30, it had a surplus, measured on an actuarial basis, of $4.8 billion. That's down from $9.7 billion at the end of fiscal 2000. As a gov-

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A Question of Trust

It would be nice to assume that since the vast majority of people are basically honest, you can believe what your advisers and service providers promise. But reality all too often proves different. The good news is that it is getting easier and easier to check up on the people you entrust with your money, your children, your home maintenance and more. The caution, of course, is that a clean record at one point doesn't guarantee future behavior. Even very smart people have been known to do some very stupid things when they find themselves in a financial bind.

You have a right to protect your assets and family from deception. If something doesn't seem right, ask questions and use the resources available to you to find out the facts.

Checking on Financial Advisers

The National Association of Securities Dealers (NASD) provides background and licensing information on all NASD registered brokers and firms at www.NASDR.com. The site also provides a listing of any disciplinary actions taken by any agencies against member firms or individuals.

For Registered Investment Advisers managing in excess of $25 million, the U.S. Securities and Exchange Commission (SEC) allows you to view the adviser's Form ADV at www.AdviserInfo.SEC.gov. The ADV contains background and operations information about the firm, including disciplinary events. For investment advisers managing less than $25 million you will need to contact specific state securities administrators. For a list of links to state regulatory agencies visit www.NASAA.org.

Service Providers Background Checks

Always check out companies and contractors beyond speaking to references the firm provides. Find out whether the Better Business Bureau has received complaints from former customers. Make certain their licenses, bonding, and various forms of insurance, including job-site liability and worker's compensation are in order. Ask for the names of suppliers and see if they are on time paying their bills. If they claim to be a member of professional organizations, make certain it's true.

Before you employ an individual, ask them to give you a signed release allowing you to do a background check. Federal law requires an applicant's written permission for a pre-employment records check. Check the applicant's Social Security number to verify name and past addresses. Review court records in places where the applicant has lived for felonies, misdemeanors, civil proceedings and sex offender listings. Driving records should be requested and a credit check made.

If you don't have the time to do the background check yourself, hire a professional to do so. Here are a number of on-line background check services covered in a recent *Wall Street Journal* article:

- USSearch.com
- ChoiceTrust.com
- MyBackgroundCheck.com
- apnaoline.org (Alliance of Professional Nanny Agencies)

The cost of background check can be surprisingly reasonable considering your potential liability from a bad hire.

The AMT Trap

The Alternative Minimum Tax (AMT) is a land mine waiting for more and more Americans, particularly retirees planning to live on long-term capital gains. The AMT was created to help limit the use of tax shelters by wealthy taxpayers, forcing them to pay their share of the federal tax burden. It's not an additional tax, but an alternative way of calculating taxes. If you are over the AMT exemption ($35,759 for single taxpayers, $49,000 for taxpayers filing jointly) you are required to calculate your taxes under both the regular tax system and AMT and pay taxes based on whichever produces the higher tax burden.

The catch is that the only deductions you can take under AMT are for charitable contributions and mortgage interest. While the AMT tax rates are lower (26-28%) than the highest marginal tax rate (38.6%), more of your income is taxed, and that is rarely a good thing.

The long-term capital gains tax rate is 20% under both the regular and AMT systems. But retirees relying on long-term gains for their income are almost certain to fall under the AMT because any deductions allowed under the regular tax system, such as property taxes or state income taxes, automatically put their tax burden lower under the marginal tax rates and throw them into the AMT.

The AMT trap was designed to impact only the richest taxpayers. But because AMT rates and exemptions haven't been indexed to inflation over the years (actually the AMT exemption will fall back to $33,750 and $45,000 in 2004 when the current increase expires) while the regular tax system's deductions, exemptions and tax brackets have, AMT is affecting more and more people each year.

Estimates are that AMT will increase federal government revenues by $18 billion this year. But its actual cost to the American public is far higher when you include tax preparation fees.

Pension Plan Perils

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ernment agency, PBGC can't go bankrupt, but it could head to Capitol Hill for additional funding, which could mean higher taxes for you and me.

Isn't our corporate accounting system great? It's only rival for bizarre logic has to be the US tax code.

Welcome to 2003!

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Vermont, by state law, are entitled to receive a free copy of their consumer credit reports once each year, and residents of Georgia, twice each year.

Below are the major credit agencies and their contact numbers.

Equifax Information Service Center
+1.800.685.1111

Trans Union Corporation
+1.800.888.4213

Experian (formerly TRW)
Complimentary Report
+1.888.397.3742 (+1.888.EXPERIAN)

5. Track Your Social Security Contributions.

It's a good idea to monitor your Social Security account throughout your working life to catch errors and to be able to estimate expected income after retirement. The Social Security Administration sends out yearly reports to wage-earners over the age of 25. Make certain to read your statement when it arrives. You can also request a statement at any time from the Social Security Administration. Visit the Administration's web site at www.ssa.gov to complete and submit a form online called SSA-7004, Request for Personal Earnings and Benefit Estimate Statement (PEBES). A toll-free number, 1-800-772-1213, is also available to request the same form in the mail, which takes about 4-6 weeks to process.

6. Budget for major expenditures.

To make certain you have the money available when you need it and not subject to the market's vagrancies or potential liquidity issues, identify major expenditures that you've planned for during the year, from remodeling to vacations, and set the money aside now if need be.

Patience is the Watchword of Successful Investing

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"Regardless of any predictions, emotional media coverage or even personal beliefs and hopes, successful investing relies on examining market trends and investing accordingly."

to designating bear markets as "cyclical" or "secular." Cyclical bear markets, while painful, tend to be short term, occurring within a long-term or secular bull market phase.

Secular bears are **long-term** periods of the market when equities go nowhere. According to James T. Kahn, American history since 1792 has consisted of nine bullish eras averaging 10+ years and eight bearish eras averaging 14+ years. The eight bearish eras — 1802-29, 1835-42, 1847-59, 1872-77, 1881-96, 1902-21, 1929-42, and 1966-82 — yielded average annual returns of minus 5.88%, before dividends, but also before inflation.

During these longer bear cycles, according to Kahn, the S&P 500 (or its reconstructed equivalent) typically fell five years in a row. While only hindsight will tell us for sure, there is a possibility that another secular bear began in 2000. High and falling P/E ratios, along with negative returns for the third consecutive year in 2002, are signs that have been associated with such eras in the past.

Forecasting the Future is an Uncertain Process at Best

Several respected analysts are predicting the market hasn't hit bottom yet. The most bearish of these, Robert Prechter maintains the Dow will collapse to 4,000, followed by a more than 90% drop from its high to under 1,000. Other bearish analysts are betting their reputations on a drop to at least the 5,000 to 6,000 range. On the other hand, experts like Ken Fisher and Laszlo Birinyi are convinced the market has hit bottom, a recovery's on the way, and investors should start buying if they haven't already done so.

Market predictions are not a perfect science. Terrorism, wars, and under funded pension funds can undermine the best of predictions. What's left in the end is the market's trend. Regardless of any predictions, emotional media coverage or personal beliefs and hopes, successful investing relies on examining market trends and investing accordingly.

Richard Russell, editor of the *Dow Theory Newsletter*, published an article years ago entitled "Rich Man, Poor Man," in which he explained why a rich man gets richer and a poor man poorer in the exact same market conditions.

Because the rich man doesn't need the money, he doesn't feel pressured to make money in the market and takes his time to invest only where he sees real opportunity, explains Russell. If no outstanding values are available, he waits. The poor man feels pressured to "make money." And because the little guy is trying to force the market to do something for him, he's usually a loser. He doesn't understand value so he constantly overpays. He's never heard the adage, *"He who understands interest — earns it. He who doesn't understand interest — pays it."* The little guy is the typical American, and he's deeply in debt, says Russell.

Patience is an investor's greatest tool. While the long-term trend of the market may be upward, it has never been a smooth journey. There are times when it is better to be on the sidelines, waiting patiently for opportunities. We can't "make" the financial markets perform the way we would like by hoping or jumping on the latest financial expert's opinion.

So sit back, conserve your capital, and let's be ready for the next real opportunity in equities.

Twisted Thinking – the Downside of Refinancing

This one had to be written by a mortgage bond holder — "Lower Mortgage Payments Will Cost Taxpayers an Estimated $10 Billion in Lost Deductions," says the December 3, 2002, issue of the *Wall Street Journal*. The premise of the article is that because individuals who refinance won't pay as much in interest, they will have to pay more taxes. The point is completely true. But the logic is twisted. What matters in the end are out-of-pocket costs.

The only reason not to refinance is if the lower tax deduction throws you into the Alternative Minimum Tax scenario and more of your income is subject to taxes. But given a choice between taking advantage of today's low interest rates and locking in 6% for 15 to 30 years, and betting on the uncertainty of your tax rate next year and over the next 30 years, we would opt for the bird in hand.

Lower interest rates mean you pay less overall. Deducting interest only saves you whatever your tax rate is. For example, drop your interest rate 1% on a $250,000 loan and you save $2,016 in interest the first year and $60,480 over 30 years. The higher your mortgage or the more you are able to drop your interest rate, naturally the greater your savings.

If you opt to keep your higher interest rate so you can deduct the interest on taxes, at a 30% tax rate, you'll save around $600 a year in taxes initially. As you pay off your loan and a higher amount of your payment goes to principal, that tax deduction will diminish.

What matters in the end is your actual out of pocket cost after taxes, not a slight reduction in taxes in exchange for paying more in interest. If you haven't refinanced and can benefit from today's low rates, find out what your options are now!

The Upside of Refinancing
Based on a $25,000 30-Year, Fixed-Rate Mortgage

Interest Rate	Monthly Interest Payment Year 1	Interest Paid Over Life of Loan	Tax Savings Over Life of Loan at 38.6%	Monthly After-Tax Out-of-Pocket Cost (Interest Only)	Total After-Tax Out-of-Pocket Cost (Interest Only)
5%	$1,040	$233,120	$89,948	$639	$143,172
6%	$1,250	$289,280	$111,662	$767	$177,618
7%	$1,460	$348,680	$134,590	$896	$214,090

I would like more information about:

- ❐ Retirement planning
- ❐ Investing lump sum distributions from retirement plans
- ❐ Risk management of mutual funds
- ❐ Investment options offered by your firm
- ❐ Past performance for your investment programs
- ❐ Tactics used by your firm to avoid market declines
- ❐ Information on your firm's history
- ❐ The following topics discussed in the newsletter ____________________

NAME ____

ADDRESS ____

CITY ________________ STATE __________ ZIP ______________

PHONE ________________ BEST TIME TO CALL ________________