

# the Investment

A D V I S O R

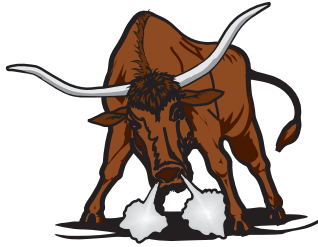
First Quarter 2001

## Get Ready for the Bull

**B**ear markets are inevitably followed by bull markets.

With that said, the Securities and Exchange Commission would like us to add the caveat that past performance should not be considered an indicator of future performance. Yet, every bear market in history has ended, followed by a period of renewed upward movement. In a way, it is an extension of the scientific principal that for every action there is an equal and opposite reaction.

Like bear markets, bull markets are best detected through hindsight. The earliest phase of a bull market is characterized by widespread disagreement over what is happening. That phase is typically followed by regret. Investors who sold late in the bear market regret it and investors who failed to invest early in the bull market regret it.



To invest in what appears to many to be a bear market requires ignoring the roar of the crowd and focusing on non-emotional technical aspects of the market. We know from experience that the stock market tends to lead the economy, turning upward before signs of an economic recovery. It also leads news coverage. The media is historically the most negative when many of our indicators are beginning to look up.

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## Enron Corp. Illustrates Risks 401(k) Investors Face

**T**oo many employees assume that investing in their employer's 401(k) plan is a relatively safe way of building retirement security, but as Enron Corp. has vividly demonstrated, 401(k) investors face risks beyond those of an Individual Retirement Account (IRA).

At the end of November, Enron went from the largest energy-trading firm to the largest corporate bankruptcy, listing nearly \$32 billion in debts. It laid off more than 5,000 employees, many of whom are out of much more than a job. Enron had frozen trading in its employees' 401(k) plans just before it announced its accounting problems. Many accounts were loaded with Enron stock, and em-

ployees couldn't sell as the bad news broke. The stock, which once traded for \$90, hit 26 cents.

The Enron debacle dramatically illustrates the value of diversification that we have been promoting for years, or more succinctly, the risks of not diversifying your portfolio. Many advisors recommend investing no more than 25% of your portfolio in the company stock of your employer, whether inside or outside of your 401(k) plan.

In addition to the basic risk of the market heading south, as it did during much of 2001, many 401(k) investors have added risks of (1) inadequate investment selections,

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## The Technology Sale of the Decade is On

**H**ard hit by losses in technology stocks, many investors are turning to the safety of staid, old-industry stocks, vowing to avoid the high flyers of the 1990s forever. That may be one of the biggest investing mistakes they will ever make. Technology didn't crash. Technology stocks crashed after a decade of very inexpensive capital that created excess capacity and a technology stock bubble that defied all logic and reason.

Technology is a constant factor in redefining business, society and the world. The companies with the greatest growth prospects are those that successfully develop and market new technologies.

If there is a danger to technology investing, it's underestimating the speed of change and the pace at which new technologies are now adopted worldwide. And some of the greatest minds of the last century have done just that...

*"Everything that can be invented has been invented."*

Charles Duell, Commissioner,  
US patents office, 1899

*"There is no reason anyone would want a computer in their home."*

Ken Olsen, President/Founder  
DEC, 1977

*"640k ought to be enough for anybody."*

Bill Gates Chairman/Founder  
Microsoft 1981

Technology investing may be down, but it's by no means out.

## Get Ready for the Bull

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Prior to the terrorist attacks of September 11, there were indications that the market was beginning to reach a bottom. Then the repercussions of the disaster stuck. In retrospect, it appears the market may have put in a bottom ten days later on September 21. But, it took until late November for investors to regain their confidence and begin moving the trillions of dollars sitting on the sidelines back into the market. On December 5, the Dow closed above 10,000 for the first time since September 5 and the Nasdaq topped 2000 for the first time since August 7, crossing above its 200-day moving average line for the first time since September 8, 2000. The Dow Jones Industrials and S&P 500 were

just below their 200-day lines, apparently poised for a breakout.

Having the confidence to invest early in a recovery requires a systematic approach to the financial markets and the willingness to be wrong some of the time — for recoveries are rarely smooth upsurges. There will undoubtedly be setbacks as the market fights its way back. But there is no denying the ability the financial markets have demonstrated over history to build wealth. We see no reason to believe this has changed, but we do believe successful investing requires divorcing emotion from the decision-making process. Fear and greed may lead the market, but they rarely lead to consistent performance.

## Enron Corp. Illustrates Risks 401(k) Investors Face

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(2) the possibility of poor record-keeping, (3) employer-business risk and (4) regulatory risk. The first risk relates to the employer's choice of investment options that are available to employees. Your selection may be limited to underperforming funds and may not have the ability to wrap professional management around your 401(k) assets.

Recordkeeping for 401(k) plans is complex and can be overwhelming to small plans. Are salary contributions making it into your account? Has the maximum allowable contribution been withheld? Were buy and sell orders made promptly and accurately? Disclaimers common to most 401(k) plans make it clear that it is the employees' responsibility to verify the accuracy of statements, not the employer's.

As Enron makes painfully clear, employer-business risk is a very real concern. The company controls the 401(k) plan, not the employees, regardless of who made the contributions. Distribution of assets for departing employees is often at the company's whim. There are few if any established rules. Overseeing 401(k) plans is the Pension and Welfare Benefit Administration and the IRS. Neither inspects or oversees 401(k) plan implementation unless they have reason to believe there is wrongdoing

and even then resources are very limited compared to the number of 401(k) plans in existence.

This is not to say that 401(k) plans, with the ability for employees to set aside far larger amounts than an IRA and benefit from the employer's matching contribution, are not a great way to build financial security. But investors must be aware of the risks they face and not put all of their eggs in one basket, as so many Enron employees evidently did.

You want to maintain as much control as possible over your 401(k) assets. Read your plan documents. Know what opportunities you have to control risk. Some plans do not prohibit participants from rolling money out of the 401(k) plan into IRAs, you just need to read the documents. Many plans also have provisions that allow employees over age 59½ and still working to request that the plan roll out money. This may be advisable, particularly if you want to add a layer of active management to protect your assets from market shifts.

If you have questions about your 401(k) assets, give us a call today. We may be able to point you in the right direction with respect to how your plan is invested and your options or refer you to the appropriate tax and legal consultants to answer your questions.

## Make Your Retirement Fund Contributions Early

Contribution limits for tax deferred retirement plans increase across the board this year. In addition, catch up provisions allow increased contributions for individuals over age 50 trying to make up for years of procrastination. The following are the new contribution limits for regular IRA and Roth IRAs. Keep in mind you may be able to add to a Roth for a non-working spouse.

	Under age 50	Over age 50
2001	\$2000	\$2000
2002	\$3000	\$3500
2003	\$3000	\$3500
2004	\$3000	\$3500
2005	\$4000	\$4500
2006	\$4000	\$5000
2007	\$4000	\$5000
2008	\$5000	\$6000

401k, 403b, 457, and SIMPLE IRA contribution limits have also increased and offer catch-up provisions for those over age 50.

To optimize potential returns for tax-deferred accounts, it pays to make your contributions as early as possible during the plan year. This allows you to compound your earnings over as much time as possible.

## Losses May Add Up to Advantageous Roth IRA Conversions

One drawback to converting a regular IRA to a Roth IRA is the need to pay income taxes on the account balance. The advantage is that once those taxes are paid, all qualified withdrawals from a Roth IRA are tax-free provided you have (1) maintained your Roth IRA for at least five years and (2) you are at least 59½ years of age. Distributions are also considered qualified if due to death or disability or made to a qualified first-time homebuyer. Roth IRAs

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## Hedge Funds Are Hot But Potentially Hazardous

With returns down for many asset classes, there's a natural tendency to look for alternatives that can bolster a lagging portfolio. In response, many investors have been pouring money into hedge funds. These alternative investments are gaining wider acceptance among individual and institutional investors with an estimated 5,000 hedge funds in the U.S. today.

A hedge fund is a private pool of capital. Investors are limited partners in a private trading venture. As such, hedge funds do not have the full protection of the securities law. The term hedge fund used to refer to an investment strategy. Today it simply refers to how the manager is compensated. Hedge funds often charge 1 to 4 percent of assets plus 20 percent of profits. That puts tremendous pressure on the managers to produce high returns.

There's the perception that hedge funds are only for the wealthy, and that is true when it comes to seasoned managers with well-documented track records. These managers often set minimums in the millions. But recently, hedge funds have proliferated with minimums as low as \$100,000 and less, often run by managers with little or no experience in the business.

Equally worrisome is the fact that the unregulated environment of the hedge fund industry attracts all those who do not want to play by the rules that shackle traditional money managers. Unregulated and operating in secrecy, hedge funds are a great place for scam artists, states Ted Siedle, a federal securities attorney, investment banker, brokerage entrepreneur and writer.

In December, the Art Institute of Chicago filed claims against a Dallas hedge fund manager stating that its monthly financial statements showing returns outperforming the market were counterfeits. In fact, the original \$43 million investment had declined as much as 90 percent.

The complete freedom that a hedge fund manager technically has in his or her investment strategy can mislead investors as to the portfolio's significant risks. The lack of regulation can also result in inadequate information needed to determine the ability of the hedge fund manager. There's also no transparency with respect to investments in the portfolio.

Redemptions are governed by the hedge fund documents and are often restricted during lock-up periods.

Some hedge funds require lengthy advance notice of redemptions and, cautions James Picerno, senior markets editor of *Bloomberg Wealth Manager* magazine, may satisfy a redemption request by delivering securities instead of cash.

Hedge fund investing requires a careful reading of the fund documents, background checks on the money managers and on-going verification that your assets are where they are supposed to be and genuinely earning the returns promoted by the hedge fund manager. Even then, the tremendous flexibility of the hedge fund managers can lead to a rapid downfall, as Long-Term Capital Management demonstrated in 1999, when it almost took the US banking system down with it.

Hedge fund investing requires a leap of faith. It's a leap we can't recommend for any but the largest investors until the industry gains greater transparency and protections for investors against fraudulent operators. As for the risks of the investment strategies used by hedge fund managers, the higher the return, the higher the risk, regardless of what the marketing documents state.

## Losses May Add Up to Advantageous Roth IRA Conversions

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can also offer more flexibility regarding withdrawals, tend to be more flexible than traditional IRAs, and accumulations of earnings can be transferred to beneficiaries tax-free.

If the impact of paying taxes kept you from converting a regular IRA to a Roth IRA before, but you hold a regular IRA account that has declined in value over the past year, now may be a good time to convert. Since the value of the account is down, you will owe less taxes now than you might have in the past and gains from the market's eventual rebound will be captured on a tax-free basis.

## Social Security Adjustments in 2002

The catch-up provisions provided in the recent tax law changes are in a way recognition from the federal government that many individuals are vulnerable to relying on Social Security at retirement. And that's not exactly an encouraging prospect, aside from the questions of Social Security's feasibility 20 to 30 years down the road.

Social Security and Supplemental Security Income (SSI) benefits paid to more than 50 million Americans will increase by 2.6% in 2002. The average monthly benefit amount for retired Social Security beneficiaries will rise from \$853 to \$874. The maximum federal SSI monthly payment to an indi-

vidual will rise from \$531 to \$545. For a couple, the monthly benefit will increase from \$796 to \$817.

While low inflation has held benefits to modest increases, higher-paid workers, representing an estimated 10.5 million of the 154 million workers paying Social Security taxes, will be paying more Social Security taxes starting 2002. The maximum amount of earnings subject to the taxable maximum will increase from \$80,000 to \$84,900. As a result, employees and employers will have to pay up to \$279 more (\$558 for the self-employed) in additional Social Security tax on higher paid individuals, a 5.6% increase from this year.

# Making the Right Investment Decisions

**M**aking the right decisions about investing doesn't start with choosing a mutual fund or company stock. It begins by making the decision of whether to manage your own investments or look to the assistance of a professional investment advisor.

Investors who choose an advisor take their financial success seriously. You've hired a professional who cares about helping you meet your financial goals.

The benefits of professional money management are numerous, especially during turbulent economic times:

- Your investment advisor is an objective third party who understands your financial goals and puts a plan in place to help you achieve them;

- Your advisor can implement your plan in a disciplined fashion, basing decisions and action on facts, not emotion;
- Investment advisors have extensive knowledge and access to information about the financial markets and investment options on a daily and often minute-by-minute basis. They dedicate themselves to managing money on a full-time basis;
- Your advisor understands the importance of diversification, risk and risk tolerance and how they are incorporated into a financial plan; and
- Your advisor is a resource you can turn to when you have questions about potential investments or current portfolio performance.

During difficult economic times, it's easy to react emotionally to the latest headlines. But that's exactly what you should not do. Your investment strategy is designed for the long term, during bull and bear markets that we know will occur over time.

If you have a question, idea or concern you'd like to discuss about your investments or the market in general, please don't hesitate to give us a call. And if you have a friend or family member whom you think would benefit from using an investment advisor, please share our name and number with them and have them give us a call. We want to be a helpful resource to you, your family and friends during uncertain times and the better days to come.

## I would like more information about:

- |                                                                                 |                                                                                 |
|---------------------------------------------------------------------------------|---------------------------------------------------------------------------------|
| <input type="checkbox"/> Retirement planning                                    | <input type="checkbox"/> Past performance for your investment programs          |
| <input type="checkbox"/> Investing lump sum distributions from retirement plans | <input type="checkbox"/> Tactics used by your firm to avoid market declines     |
| <input type="checkbox"/> Risk management of mutual funds                        | <input type="checkbox"/> Information on your firm's history                     |
| <input type="checkbox"/> Investment options offered by your firm                | <input type="checkbox"/> The following topics discussed in the newsletter _____ |

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CITY \_\_\_\_\_ STATE \_\_\_\_\_ ZIP \_\_\_\_\_

PHONE \_\_\_\_\_ BEST TIME TO CALL \_\_\_\_\_