

# FourBits®

Making Better Investment Decisions

## Balancing Act

When investing for long-term goals, keeping an eye on asset allocation is critical. Over time, investment gains or losses can cause a portfolio's allocation to become unbalanced. When this happens, the portfolio may become more aggressive — or more conservative — than originally intended.

### Your Asset Allocation

If you are a long-term investor with a high tolerance for risk, you may be comfortable with a portfolio heavily weighted in stocks, with less of your total assets invested in bonds and cash equivalent investments. If you are more conservative, you might have a smaller portion of your portfolio in stocks and more in bonds and cash equivalents. The asset mix that is right for you should consider your risk tolerance, your investing time frame, and your financial goals.

### Investments Acting Up

As time goes by, your asset allocation is likely to shift based on the relative performance of the different types of investments included in your portfolio. For example, suppose your stock investments increase in value significantly. Instead of representing 60% of your portfolio, stocks may represent 75% of your portfolio. Since stocks carry more risk than bonds or cash equivalent investments,

your portfolio has become more aggressive than you originally intended.

### Get in on the Act

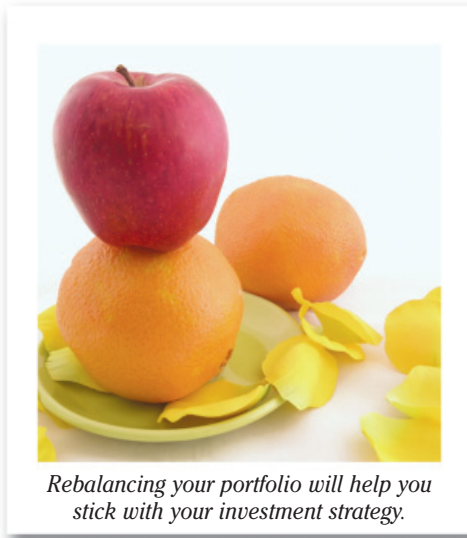
If your portfolio has become unbalanced, it is relatively simple to rebalance. You can sell investments in the overweighted asset class and reinvest your funds in the underweighted

classes. Before selling appreciated investments held outside of a tax-favored retirement account, however, consider the tax implications. Another approach is to invest additional money in the underweighted asset classes until you regain your desired allocation.

Rebalancing will help you stick with your investment strategy. Of course, it may be difficult to decrease your exposure to an asset class or

market sector that is doing very well. But keep in mind that the investment markets have a history of ups and downs. What performs well today may face a rough patch in the not-too-distant future. Similarly, asset classes that are currently underperforming may be tomorrow's winners.

It's a good idea to review your asset allocation at least once a year. Your financial professional can help you determine if you need to rebalance your portfolio.



*Rebalancing your portfolio will help you stick with your investment strategy.*

## Inheriting a Plan Account

Last year's sweeping pension legislation has made it less taxing to inherit a retirement plan account from someone who isn't your spouse. Now, you may not get hit with an immediate income-tax bill if you inherit a 401(k) or profit-sharing account from your parent, grandparent, or another relative or loved one.

Under the old law, only a surviving spouse could roll over money inherited from an employer-sponsored retirement plan into an individual retirement account (IRA). A non-spouse beneficiary typically had to withdraw money from the plan within a very short time frame and pay taxes on the distributions. This could have meant an unexpected and significant tax bill.

Now, if you inherit a plan account from a non-spouse, you are allowed to have the plan assets transferred directly into an IRA. You can then spread out distributions from the IRA — and the related tax payments. Depending on the specific situation, it may be possible to stretch the distributions over your life expectancy.

# The Bottom Line

## Charitable IRA Rollovers

Thanks to recent legislation, you can donate up to \$100,000 tax free from your IRA(s) this year if you are age 70½ or older. The contributions must be made *directly* from your IRA to qualified charitable organizations before January 1, 2008.

A donation made from your IRA can't also be deducted as a charitable contribution on your tax return because that would provide a double tax benefit.

Source: *The Wall Street Journal* (August 9, 2006)

## How Much Will You Need?

Do you know how much money you'll need to save for a comfortable retirement? According to the Office of Personnel Management, fewer than half of the federal employees responding to a recent survey had calculated their retirement needs, and four in ten said they were not confident of their ability to make investment decisions. While 15% reported savings of less than \$5,000, another 27% have saved \$150,000 or more. Note that federal retirees may also receive pension or annuity income.

Source: *The Washington Post* (August 15, 2006)

## What's New in College Savings

Saving for your child's college education is hard work. But recent legislation may make it a little less difficult for parents to put funds aside for college costs.

### Favorable Financial Aid Treatment Expanded

Deciding where to save money for your children's college costs can be tricky, especially since the Free Application for Federal Student Aid (FAFSA) assesses student's assets at a much higher rate than parents' assets in determining financial need. Before the Deficit Reduction Act of 2005 (DRA), only 529 savings accounts received the favorable financial aid treatment of being counted as an asset of the parents and not the student. DRA, however, expanded favorable financial aid treatment to 529 prepaid tuition plans and Coverdell education savings accounts (ESAs). (You may be able to exclude 529 savings accounts and ESAs owned by a dependent student on the FAFSA.)



Recent legislation may make it easier for parents to save for college costs.

### Special Tax Treatment Sunset Cancelled

Thanks to the Pension Protection Act of 2006 (PPA), the sun won't go down on the special income-tax treatment of 529 plans. Distributions from 529 plans that are used to pay qualified higher education expenses at an eligible school are not subject to federal income taxes.

This special tax treatment was scheduled to sunset after 2010. PPA, however, repealed the sunset so parents and students can now benefit from permanent tax-exempt distributions from their 529 plans.

Note that certain 529 plan benefits may not be available unless specific requirements (e.g., residency) are met. There also may be restrictions on the timing of distributions

and how they may be used.

*Before investing, consider the investment objectives, risks, and charges and expenses associated with municipal fund securities. The issuer's official statement contains more information about municipal fund securities, and you should read it carefully before investing.*

## Have That Awkward Chat

No one wants to talk about what should be done if you or a family member becomes physically or mentally incapacitated. However, you need to protect yourself and your family by having this difficult discussion.

Unless you ask, you may not know how your spouse or parents feel about what should happen if they should become incapacitated. Finding out now may make an already difficult situation easier down the road.

Once you and your family have made your wishes known to each other, you may want to make some legal arrangements ahead of time.

For example, consider executing durable powers of attorney and living wills.

A durable power of attorney names the person or persons you choose to make financial and/or health-care decisions for you when you no longer can. (A durable power of attorney for health care is sometimes called a health-care proxy.) This person could be your spouse, adult child, relative, or friend. You can specify exactly what powers this person will have. A living will is a directive to physicians stating exactly what kind of care you do and don't want if you're terminally ill and incapacitated.

# In Your Best Interest

## Time To Meet and Greet

Is it time for a sit-down with your financial professional? At least once a year, you should meet with your financial professional to review how your investments are doing and take a look at whether you're still on track to reach your financial planning and retirement goals. These meetings are an essential element of the financial planning process that you shouldn't skip.

### Review Performance

At the meeting, you and your financial professional will probably review how your investments have performed. When you set up your financial plan, you chose investments designed to help you meet your short- and long-term goals. But, over time, your investments may not have performed as you expected. Some investments may have done well, while others may have performed poorly. Your financial professional can help you decide if these investments are still right for your plan or if it's time to make some different choices.



*Meeting with your financial professional is an essential part of the planning process.*

### Get Risk Under Control

Has your risk tolerance changed since your last meeting? A significant change in your family situation or an impending life change, such as retirement, may make you more or less tolerant of investment risk. Or, depending on how your investments have performed over time, your portfolio's risk exposure may have changed. You now may face more risk than you're comfortable with. Conversely, your portfolio may hold too many "safe" investments, which could put you in jeopardy of falling short of your goals. Your financial professional can help you adjust your portfolio so that your investments are in line with your current needs.

### Check Diversification

One way to help protect your portfolio from investment risk is to diversify your investments\*. Choosing a mix of different types of assets may lessen the overall impact if one asset type performs poorly. On the other hand, if one asset type performs very well, your portfolio may end up holding more of that asset type than you originally wanted. Thus, over time, your portfolio may become less diversified. Your financial professional can help you review your portfolio to make sure it is appropriately diversified, or help you adjust your investment mix if you decide that's necessary.

### Discuss Your Estate Plan

Your meeting with your financial professional is also a good time to discuss other financial issues. Is your estate plan up to date? If there have been any changes in your family — births, deaths, marriages, or divorces — you may need to modify your estate plan.

### Review Insurance Coverage

You also may need to consider your life insurance coverage. Is it still adequate for your current needs? A change in your family also will affect your insurance needs. Plus, if you recently purchased a house or have a child approaching college age, you'll want to make sure your insurance will cover the mortgage or tuition costs.

### Plan To Meet

Meeting with your financial professional can help you take care of your financial concerns. Give us a call to set up a meeting.

*\* Diversification does not ensure a profit or protect against loss in a declining market.*

### Health Insurance Ills

While many small businesses offer some type of health insurance to their employees, some are reconsidering that particular benefit. Currently, 58% of small businesses provide health insurance coverage. Of the small businesses that provide coverage, 56% pay for at least 80% of their employees' overall health-care costs. According to a recent survey, however, 11% of small-business owners who currently offer benefits are considering dropping their health insurance plans.

*Source: The Wall Street Journal (August 15, 2006)*

### 401(k) Balances Increase

During a period that included one of the worst bear markets in U.S. history, the average 401(k) account balance increased by 50%, according to a study by the Employee Benefit Research Institute and the Investment Company Institute. The study was compiled from a database that contains account information for 17.6 million 401(k) plan participants. The average balance rose from \$67,785 at year-end 1999 to \$102,014 by the end of 2005. The median account balance more than doubled during this time period to \$54,591.

*Source: InvestmentNews (August 24, 2006)*

# The Closing Bell

## Retirement Investing Simplified

**M**ore employer-sponsored retirement savings plans are offering lifecycle or lifestyle funds as investment options. These funds are designed for investors who don't want to take a hands-on approach in managing their investments. A lifecycle/lifestyle fund can provide a diversified, professionally managed mix of stocks, bonds, and cash through a single investment selection.

### Explore Your Options

A typical lifecycle fund is designed so that you choose a fund based on your expected retirement year. The fund allocates investments to become more conservative as your retirement date nears. Generally, by the time your target year arrives, the fund will be heavily weighted in fixed-income investments.

Other lifecycle/lifestyle funds are "risk based." You choose a fund that corresponds with your personal risk tolerance, from conservative to aggressive, and should switch to another fund if your risk tolerance or circumstances change.

### Avoid Pitfalls

If you choose a lifecycle or lifestyle fund,

remember that it provides built-in diversification and asset allocation, and generally is designed to be the sole investment in your retirement account. (Diversification does not ensure a profit or protect against loss in a declining market.) Investing in additional funds may make your portfolio more conservative or aggressive than planned.



*A lifecycle/lifestyle fund can provide a diversified mix of investments in one selection.*

### Ask for Help

If you're thinking of investing your retirement account in a lifecycle/lifestyle fund, take some time to sit down with your financial professional to review *all* of your investments.

Looking at your portfolio as a whole can help you determine if the lifecycle/lifestyle approach is right for your situation.

*You should consider a mutual fund's investment*

*objectives, charges, expenses, and risks carefully before you invest. The fund's prospectus, which can be obtained from your financial representative, contains this and other information about the fund. Read the prospectus carefully before you invest or send money. Shares, when redeemed, may be worth more or less than their original cost.*

## Boomerang Kids

Many recent college graduates are moving back in with Mom and Dad. Due to low starting salaries, minimal savings, and high educational debts, young adults often have a tough time living within a budget. So, to save money, they live with their parents. According to the Student Monitor, a graduate's average student loan debt is \$25,760 and will take almost eight years to pay off.

*Source: The Washington Post (September 3, 2006)*

## Preferred Index

Standard & Poor's has launched the first investable preferred stock index. The S&P U.S. Preferred Stock Index represents the roughly \$200 billion U.S. preferred stock market. The index includes preferred stocks issued by U.S. entities that meet certain requirements.

*Source: InvestmentNews (September 15, 2006)*