Portfolio Notes

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HAPPY BIRTHDAY EGTRRA!

June 7 marked the first birthday of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA). You should know that there are significantly improved opportunities to save for retirement.

Beginning this year:

- Annual Roth IRA and Regular IRA contributions rise to $3,000, $3,500 if you're over age 50.
- 401K plan pre tax contributions rise to $11,000, $12,000 if you're over age 50.
- SIMPLE plan contributions go from $6,500 to $7,000.
- When changing jobs, the IRS has been ordered to be more lenient when the 60 day rollover rule is exceeded.
- 403B plan assets can be transferred into 401K plans, with the employer's permission and vice versa.

Estate Taxes:

Think about how difficult it is to build an estate: How much can you expect to keep after raising a family, paying income taxes, social security taxes, and unemployment tax on earnings, plus sales tax, gasoline tax, airport tax, lodging and highway tolls on consumption? For those who have managed to build an estate, your beneficiaries will be allowed to keep more of your bequest, at least for a while.

In one of the silliest legislative compromises to come out of Washington, estate taxes are scheduled to decline from 55% to zero over the next ten years, then reappear at 55% in year 11! For most families, the more important benefit of EGTRRA is the rise in the estate tax exemption. Up to $1,000,000 can be transferred exempt from estate tax by one individual. With proper estate planning a couple can leave $2,000,000 before confiscation begins.

Given that many homes in Orange County are pushing $1,000,000 in value, many estates are already nearing or beyond even this 2002 limit! Not to worry-the estate tax exemption ratchets up to $3,500,000 per individual ($7,000,000 per couple with proper planning) by 2010. However if you and your spouse are *unlucky* enough to live beyond that date Congress has ruled that the exemption will fall back to the 2002 level of $1,000,000!!! And for hash like this we reward our elected representatives with high salaries and extremely generous pensions.

Education Savings Provisions:

The third important savings arena that was enhanced by EGTRRA 2001 is in the realm of education savings. Recognizing that the middle class gets very little tax help in paying for college, Congress finally responded to years of pleading by the American parent. While the many provisions are too detailed for this short summary, the key program to look into is known as a "Qualified Tuition Program", a.k.a. "Section 529 plans". Here are the highlighted features of this bonanza for college savers:

1. Ability to save large amounts of money.
2. All earnings income tax free.
3. Pays for wide variety of education: college, graduate, and vocational.
4. Applicable to both tuition and room & board.
5. Powerful estate planning tool:
    - donor does not lose control of funds during savings period.
    - children never gain control of funds, only available for education.
    - potential to bring funds back into estate (penalty) if unused for education.
    - donor removes funds from estate, reducing income tax.
    - donor removes funds from estate, reducing estate tax and fees.
6. Sponsored by states, investments provided by mutual fund companies.

CERTIFIED FINANCIAL PLANNER™

Gary Miller has over 28 years experience in the financial services industry as both an analyst and financial advisor. Currently he provides service to clients as a CERTIFIED FINANCIAL PLANNER™ practitioner. Gary holds a certificate in Personal Financial Planning from University of California, Irvine; and is a Board member of the Orange County Chapter of the Financial Planning Association.

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Opening and managing these plans is not as easy as some promoters suggest, especially if you wish to coordinate your funding of a QTP with your estate plan. We have direct experience to offer, so please contact Gary Miller if you need help with set-up and with figuring out the investment choices.

BONDS, ANYONE?

Well known, if not well practiced is the idea of diversification. Good financial diversification includes fixed income instruments, the majority of which will be bonds. Bonds are IOU's from borrowers who promise to pay interest while using your money. Often the interest is paid twice a year sometimes it is all paid at maturity of the bond (as in the case of zero coupon bonds) The bond market has proven to be a safe haven for our investors over the past 30 months of challenging stock market behavior. We also seek out opportunities in preferred stock (senior to common stock) and convertible bonds (bonds that pay attractive interest, and also will benefit from a rise in the price of the stock of the issuer).

For prospective clients with bonds nearing maturity, it is worth considering the potential value of a relationship with an independent financial advisor such as ourselves. Many individual investors do not realize that bonds are sold at a "mark up" or retail price. The broker purchases or underwrites bonds in large quantities at, for example $983 per bond, then sells them to its customers for about $1000 (par value). This two percent spread is typical. It may be justified too, if the investor plans to hold the bond to maturity five or ten years into the future. After all, a 2% profit must pay for years of service, monthly reports etc. Still, one cannot blame an investor for seeking a broker willing to take a smaller mark-up, particularly if customer service from the broker is lacking. This is where we may improve on the situation. For most transactions involving direct bond purchases, we seek quotes from more than one firm. Part of the job of a fee-only advisor is to obtain the best possible price for the customer.

Bond mutual funds are also popular. One of the most widely respected bond fund managers , independently rated, handles assets for many of our client accounts. This fund has risen 25% over the past three years. If bonds are in your current portfolio, or you think they should be, give us a call!

"Stock Market Stinks – Let's Stay Away"

This is the essence of the argument we're hearing from some prospective clients. It's been a long time since people retreated like this from stocks. First of all, we agree there's more to investing than the stock market. We steadfastly practiced diversification for clients even when everyone was piling into the "can't lose" stock market of the 1990's. We still diversify our client's portfolios into real estate, international equities, special situations and bonds. We firmly believe, however that there is a demonstrated benefit of stocks as a long term road to wealth and financial security.

But here's the secret to success: we've learned to buy stocks like savvy shoppers buy clothing: <u>when there's a sale going on!</u> There are plenty of wonderful companies to be owned. The trick is waiting to obtain them at bargain prices. We carry a shopping list and wait for the right price to pounce! Some of our favorites, like Lincare, Shaw Group and Valero ran up after our initial purchases. With a recent retreat in price, we continue to add these fine but undervalued companies to client portfolios. We sincerely believe that a few years from now most of our choices will be trading at higher prices. Armed with careful research and a valuation system, we feel qualified to guide investors to an exciting world of investment opportunities. The current bear market holds the promise of finding more great companies at bargain prices.

Thank you, Gillian Kumm!

Gillian and husband Fred have been clients for about seven years, Gillian's background includes many years as an Administrative Assistant to senior executives at some of California's top lending institutions, so her kind letter, received April 30 is all the more meaningful. She writes: "I thought I would take a moment to let you know how much Fred and I have enjoyed being your clients." After recounting how our relationship began and reminding me that I always urged portfolio diversification, Gillian goes on to note: "I had a strong wish to jump into some tech stocks a couple of years ago. Even this move was not too devastating , since you suggested that if I really wanted to have a few tech stocks, they should be of a certain caliber. They actually did not do too badly, but I then learned my lesson, and at your suggestion, switched out of tech stocks and into bonds. From there we have recovered and I am now ahead of the game!"

To this gratifying letter, I can only reply that I appreciate the opportunity to be of service.