The MONEY MONITOR

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Now's A Time To Recall Financial Planning Basics

Just a few years ago, almost everyone knew at least one person who had made a fortune in the stock market. Today, many of us have lost a fortune. For those who are wondering what went wrong, here's a refresher course in financial planning basics.

Diversification. In the late 1990's, many investors thought diversification meant buying three computer stocks and two Internet stocks. Others assumed they were being prudent because they owned a dozen mutual funds. But true diversification means buying a range of investments in markets that do not move in lockstep with each other. Through most of the 1990s, growth stocks were the spectacular performers; in recent years value stocks have been successful. A balanced portfolio will have both. It will also include bonds. But just starting out with the right mix isn't enough; you also need to rebalance your portfolio regularly, trimming positions that have done well and adding to others that may be poised to rebound.

Planning. Establishing clear life goals and a long-term strategy is the essence of sound financial planning. A solid plan lays out the amount you must save annually, assuming an expected average rate of return, to reach your financial targets. It prepares you for future expenses, such as a child's college education, and unexpected setbacks, such as premature death or disability.

Saving. Money doesn't grow on trees, but it does grow provided you invest it. The more you put aside and the longer you allow it to compound, the better off you'll be. The rule of 72 is the easiest way to see how this works*. Simply divide 72 by your rate of return to get the number of years it will take for your money to double. For example, with an 8% return, your investment will double in nine years and quadruple in 18. A steady, automatic withdrawal from your paycheck is probably the most effective way to save. That way, you don't miss the money, because you never see it, and you're able to load up on assets when they're doing poorly and reap the benefits when they go up.

Retirement contributions. The government rewards savers by offering tax benefits to retirement accounts such as 401(k)s, 403(b)s, and IRAs. In most cases, you contribute pre-tax dollars and the money grows tax-deferred, meaning you don't owe taxes on gains until you withdraw the money. With Roth IRAs, you contribute money that has already been taxed but your withdrawals are tax-free. Either way, the boost from Uncle Sam is so generous that it's worth stuffing as much as possible into retirement accounts before allocating to regular savings and taxable accounts.

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Remembering The Important Things In 2009

As we deal with the financial crisis in the markets and the overall economy, it is helpful to review some time-tested principles of financial planning. The article on this page provides an excellent reminder of important concepts which can help us all remain disciplined during these difficult economic times.

On a lighter note, page 2 contains an excellent article discussing the numerous health benefits associated with regular exercise, and specifically taking regular walks.

Despite the booming popularity of 529 College Savings Plans, many people remain unfamiliar with their benefits and features. The article on page 3 offers pertinent information for those interested in college savings for children or grandchildren.

As we approach tax season, a recent U.S. Supreme Court decision has clarified the rule concerning the deductibility of investment advisory fees on trust tax returns. The article at the bottom of page 2 and 3 explains the ramifications of this ruling. The ruling does not affect the deductibility of advisory fees for individual tax returns.

For many people, one of the most important things they look for in an advisor is trustworthiness. Page 4 contains an article detailing the important characteristics of a Fiduciary. The Monitor Group functions as a fiduciary in all client relationships, so read this article carefully.

If you have additional questions related to any of these topics, please give us a call. We look forward to working with you in 2009.

Ken Robinson, CFP®

A Walk Every Day Can Keep Aging At Bay

It's much easier to talk the talk about staying young than it is to walk the walk. Starting in our 20s and 30s, we commence a long, seemingly inevitable physical deterioration. Our maximum heart rate declines, and with it the amount of oxygen-bearing blood the heart can pump. Muscle is gradually replaced with fat and weight edges upward. And decade by decade, as oxygen intake drops, it becomes a little harder just to get around. Eventually, in our 70s, 80s, or 90s, most of us lose our "functional independence," the ability to live on our own. We move to assisted-living or nursing homes because, literally, our living needs to be assisted.

But what if there were a simple way to turn back the clock? In a recent article in the British Journal of Sports Medicine, Roy Shephard, a physician at the University of Toronto, reports that for people 64 and older, a vigorous, hour-long walk five days a week cuts a dozen years from their biological age. In a review of other published work on the subject, Shephard found that such an exercise program could also extend a person's functional independence, which tends to be lost when maximal oxygen intake falls below 18 milliliters per kilogram per minute in men and 15 ml/kg/min in women.

Without this kind of exercise program, about 10 years of physical aging normally corresponds with a loss of about five ml/kg/min. But Shephard found that beginning a program of vigorous aerobic exercise could restore about 25% of maximal oxygen intake within three months, raising that essential level by an average of six ml/kg/min and decreasing biological age by 12 years.

Shephard also found that regular exercise provides other benefits, helping prevent conditions that may hasten aging including obesity, high blood pressure, diabetes, heart disease, osteoporosis, and even some kinds of cancer. And the improved muscle tone that comes with brisk walking, swimming, or other aerobic activities may help older people avoid falls.

Another study, from Texas, further highlights what exercise can do. In 1966, five healthy 20-year-olds were kept in bed around the clock for three weeks—and suffered many of the ills normally associated with aging. They gained weight, their heart rates and blood pressure rose, and their hearts lost pumping capacity. Then, an eight-week exercise program more than reversed the effects of inactivity. In a follow-up with the men 30 years later, actual aging had imitated the effects of the forced bed rest. But here too, an endurance exercise regimen undid most of the damage, restoring all of their lost aerobic capacity.

The moral? Exercise always helps, and it's never too late to start pushing back the hands of time. ●

Court Decision Limits Trusts' Deductible Fees

The U.S. Supreme Court recently handed down a high-profile ruling involving the heirs of a family fortune (Knight, Trustee of William L. Rudkin Testamentary Trust v. IRS, S. Ct. Dkt. No. 06-1286, 1/16/08). In the case, the high court applied the "2% floor" for deducting miscellaneous expenses to the investment advisory fees incurred by a trust. The unanimous decision changes the rules and could increase the tax bills of other affluent families.

Normally, individuals are able to deduct miscellaneous expenses, such as investment advisory fees and other investment-related costs, only to the extent the annual total exceeds 2% of the taxpayers' adjusted gross income (AGI). So if you have an AGI of $150,000 and pay $2,500 of miscellaneous expenses, you're out of luck, because 2% of your income—the 2% floor—is $3,000, $500 higher than your expenses.

The rules vary slightly for trusts and estates, but the basic premise is the same. A trust or estate may deduct only the portion of its miscellaneous expenses that goes beyond the 2%-of-income threshold. But there has been an important if rather technical exception: When fees are for administering a trust or estate—and would not have occurred had the assets been held in another kind of entity—the 2% floor doesn't apply, and the fees are fully deductible.

This is far from the first time courts have been asked to rule on whether investment advisory fees paid to a trust qualify for this exception. Now, the Supreme Court has had the final say, in a case relating to a trust initially established by Henry Rudkin, patriarch of the Pepperidge Farm pastry company.

The trust handling the Rudkin estate deducted more than $22,000 in investment advisory fees, with

Does Your 529 College Savings Plan Match Up?

When the Pension Protection Act of 2006 made 529 college savings plans a permanent part of the tax code, it ended most debate about the best way to invest for educational expenses. However, there are dozens of state-sponsored plans to consider, each varying in everything from investment choices and performance to plan costs and tax advantages. Understanding the differences can help you find a plan that makes the most of your college savings.

All 529 plans offer these benefits:

- No income requirements and very high caps on account contributions
- No federal income tax on investment earnings, nor on distributions to pay qualified college costs
- Plan owners retain control of how assets are used. If a plan owner's child doesn't go to college, he can name another family member as beneficiary or even take back contributions, though normally with a 10% penalty and tax on investment profits. (One strategy lets you avoid taxes and penalties by making a charitable donation of an unused plan).
- Your ownership of plan assets means favorable treatment in federal financial aid formulas, increasing your child's chance of qualifying for federal aid (though it may lower aid packages from institutions).
- You can lump together five years' annual gift-tax exclusions to make a single 529 contribution. Because you and your spouse may each give up to $13,000 a year without gift-tax liability, you can jump-start a plan with up to $130,000 while also removing that money from your estate if you live for five more years.

Get past the basics, and differences among plans emerge. A distinguishing feature is whether the plan is sold directly to investors or through a financial advisor. Savingforcollege.com and Morningstar.com provide databases of 529 plans and guidance on plan selection. Savingforcollege rates effectiveness on a one- to five-cap scale, and each year Morningstar names the country's five best and worst plans. In both cases, evaluations are based on several criteria:

Costs. Some plans dun you for enrollment, account maintenance, and program management charges, while others charge only for your underlying investment expenses, which may range from a few basis points annually to nearly 2%. Each basis point equals 1/100th of a percent. Comparing 10-year costs on a $10,000 investment, Savingforcollege found overall expenses ranging from $0 (for investing in one state's fixed-earning plan) to $2,616. Since fees are a steady drain on investment performance, it makes sense to choose a low-cost plan.

Investment options. Whereas some plans offer just one or two kinds of investments, others provide a broad range of choices. In some cases, your money will be managed as part of a state pension fund. Other possibilities include age-based portfolios that dial down risk as a beneficiary approaches the start of college; static portfolios pegged to investors' risk tolerances or classified by asset type (equity, fixed-income, balanced) menus of individual index or actively managed mutual funds, and money market funds. You'll want a plan that gives you well-diversified choices from a well-regarded fund family. And again, low expense ratios are essential.

Perks for state residents. Many states make plans available to out-of-staters; but all else being equal, an in-state plan may be preferable since they often provide tax deductions or credits for contributions and even contribution matches for low-income residents.

Other advantages/disadvantages. Most 529 plans let you enroll, fund plans, and check balances on the Web. A few plans restrict ownership changes, and a handful of states let out-of-state plan enrollees pay in-state tuition. Some plans have agreements with outside credit-card rewards or scholarship programs that can add to savings.

All of these criteria, useful for evaluating a prospective plan, can also help you gauge the effectiveness of an existing 529 plan. If yours comes up short, plan-to-plan transfers are usually allowed once every 12 months, and you can also establish multiple accounts with different plan sponsors for a single beneficiary. You may also want to explore other savings vehicles like Upromise.com, where you get a kick-back for consumer products that you buy.

You should consider a plan's investment objectives, risks, charges, and expenses carefully before you invest. The issuer's official statement contains this and other information about the plan and should be read carefully before investing. Investors should consider whether the investor's or designated beneficiary's home state offers any state tax or other benefits that are only available for investors in such state's qualified tuition program. A prospectus may be obtained from us or from the fund company directly.

the trust administrator claiming that the 2% floor on miscellaneous expenses should not apply. But the IRS disagreed and imposed the 2% floor, reducing the trust's deduction to less than $5,000.

The Supreme Court determined that the costs incurred by trusts qualifying for the exception from the 2% floor are limited to expenses that *would not* commonly or customarily be incurred by individuals. That's different, the court ruled, from fees that individuals *could not* have to pay. As a result, the deductibility of most investment advisory fees paid by trusts is limited by the 2% floor.

This decision does leave the door open—just a crack—for a full deduction of certain unusual types of investment fees. But IRS regulations for deducting trust fees, drawn up before the Supreme Court ruling, will now have to be revised. Until that happens, estate administrators and attorneys will need to proceed with caution. ●

Trust A Fiduciary To Act In Your Best Interest

You may have heard of the term "fiduciary," but do you understand what it means for your finances? Is there really a difference between a fiduciary and a non-fiduciary advisor? You betcha. And that difference is you.

A fiduciary has a legal obligation to act in your best interests, above his own and those of his firm. While many industry associations have certain fiduciary recommendations or oaths that they require of their members, all fiduciaries must adhere to these principles of the advisor-client relationship:

1. Be competent and exercise due care
2. Loyalty to the client
3. Full and adequate disclosure

Today, Registered Investment Advisors (RIAs) commit to a fiduciary responsibility and have to state it in writing. Commission-only reps, on the other hand, are merely in the business of making financial transactions—like helping you to buy mutual funds or annuities. They have no obligation to choose the investments that work best for you, and naturally may steer you towards suitable, but not the most ideal investments that give them greater commissions.

Hybrid advisors—those who work on both commissions and fees—have a more opaque situation. They can charge you rates for providing advice, but then can also receive commissions for selling you certain investments. By receiving commissions, the objectivity of their recommendations becomes uncertain.

With a fiduciary advisor, the clients' needs must come first. If there are any conflicts of interest, they must be fully disclosed. A fiduciary advisor carefully assesses your financial situation and recommends a diversified portfolio that serves your financial goals. The fiduciary advisor will start with what you want to achieve—from paying your children's college costs or buying a second home, to funding your retirement—and considers how long you have to get there. Your fiduciary probes your comfort level with investment risk then designs a mix of investments most likely to move you toward your objectives. He also analyzes your need for insurance and assesses the impact of taxes.

A 2007 federal court ruling helped clarify the distinction between financial planners and advisors and non-fiduciary fee-based advisors affiliated with broker/dealers. The court ruling ended an exemption from the Investment Advisors Act of 1940 that had allowed broker/dealer-affiliated advisors to charge fees and call themselves financial planners and investment advisors while not being held to a fiduciary standard of conduct.

When dealing with our firm, you don't have to worry about conflicts of interest related to selling products. We have a legal obligation and a professional oath to put your interests first, and you can trust that we will strive to go above and beyond that obligation. ●

Financial Planning Basics

(Continued from page 1)

Tax planning. Hidden within hundreds of pages of tax laws are a broad range of special breaks for taxpayers. Shifting income from one year to another, selling assets that have lost money to balance out gains from top performers, and making contributions to educational savings accounts are just three possibilities. Review your tax situation with us at the beginning of the year and again in December.

Insurance. Planning for the unexpected is the key when determining insurance needs. You should have enough life insurance to meet heirs' long-term needs. Your health insurance should include coverage of catastrophic accidents or illnesses. Disability insurance is relatively inexpensive, but could make a big difference if you need it. And you should seriously consider long-term care insurance if you don't think your retirement income will be sufficient to pay for nursing home care.

Estate planning. Having the right estate plan will ensure that your wishes are respected. If you have substantial assets, developing a well-thought-out estate plan can minimize taxes even while you are alive and maximize the amount you are able to leave to loved ones and your favorite charities. Even if you don't have enough in your estate to be liable for federal or state estate taxes, having a valid will can save your heirs a lot of trouble and money.

In the dying days of the 20th century, there was talk about how the old financial rules no longer applied. "It's different this time," everyone said. But it wasn't all that different, and millions of investors lost ground and time on the road to their financial goals. It's never fun to start over, but it does give you one more chance to do everything right. Taking care of these basics should prepare you well, and we are happy to help. ●

***The Rule of 72 is hypothetical and there can be no assurance that any investment will double within the specified timeframe.**

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