Wealth Management

KANE COMPANY

A FEE-ONLY REGISTERED INVESTMENT ADVISOR

Certified Public Accountants and Financial Advisors

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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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Highlights For The New Year

I recently returned from the AICPA National Personal Financial Planning Conference for PFS credential holders, and even though it was held in beautiful San Diego, we were literally in sessions from sunrise to sunset!

According to speakers like Gene Fama Jr. from DFA Funds and David Kelly from JPMorgan, equity markets will again give long-term equity holders a premium for taking risk. As Gene Fama Jr. so eloquently put it, "Risk Happens," but now that you have assumed the downside of risk, you'd might as well hang in there for the eventual rewards.

As we experience a few quarters of negative GDP growth, we should eventually see the economy expand in excess of the average of 3%. In other words, this recession will eventually turn and we will have abundantly positive GDP to make up for the negative quarters and revert to the long-term average. Therefore, growth is not forever lost, but merely delayed.

In tax-related news, the required minimum distributions normally required for inherited IRAs or for those over age 70-1/2 has been waived for 2009. Therefore, even if you are usually required to draw down your IRA, you can suspend the withdrawal for one year. This could be a great opportunity to take another look at converting part of your IRA to Roth IRA status and thus avoid any tax on future growth.

Steven L. Kane, CPA/PFS, CFP®

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. She probes your comfort level with investment risk then designs a mix of investments most likely to move you toward your objectives. She 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. ●

Ensuring A Smooth, Smart IRA Rollover

When retirement finally beckons and you begin to tap the funds in your 401(k) or other retirement plan, you can expect to give the IRS its share—at ordinary income tax rates as high as 35% of any withdrawal. But if you don't need the cash immediately, a better option may be to transfer the money to an individual retirement plan, or IRA.

A properly executed rollover to an IRA postpones current tax on the funds you transfer and keeps the money growing tax-deferred. (You can do this when changing employers as well as at retirement.) Eventually, you must make taxable withdrawals, but not until the year after the year in which you turn age 70½. It's also possible to transfer money from an existing IRA to another IRA, to get a better menu of investments, say, or to consolidate accounts.

Though making a successful rollover isn't difficult, several pitfalls could lead to unnecessary taxes. Avoid these six common mistakes.

1. Not meeting the rollover deadline. The tax law requires you to complete a rollover within 60 days of receiving funds from your cashed-out retirement plan. Otherwise, the distribution is fully taxable on the current year's return, and you could face a 10% penalty for a premature withdrawal if you're under age 59½. That could get pretty expensive—50% or more of the value of your account when you consider federal and state taxes along with the 10% federal penalty and possible state penalties.

2. Not arranging a trustee-to-trustee transfer. Unless you make other arrangements, your company's retirement plan administrator will impose 20% income tax withholding on a payout, even if you intend to meet the 60-day deadline. Though you may recoup the money when you file your taxes, you'll have to come up with the cash before then to complete a tax-free

Why Reverse Mortgages Are Often Overlooked

Even after the housing bust, your home may be your largest single asset, and like other investments, it could be tapped to provide income during retirement. Yet the vast majority of older homeowners choose not to use their home equity, and they're particularly hesitant to take a reverse mortgage, which can provide regular payments or a line of credit throughout retirement. Less than 1% of eligible homeowners have reverse mortgages, and a recent AARP survey sought to determine why the other 99% aren't interested.

At first glance, a reverse mortgage may seem a logical way to unlock a home's value to generate retirement cash. The maximum amount homeowners can borrow is based on current interest rates, their age, and the value, location, and amount of equity in the house. The older the borrower—and the more valuable the house—the greater the equity that can be tapped. Loan proceeds may come to them either as a lump sum, monthly payments, or a line of credit they can draw down as needed. There's no repayment until the homeowner dies or sells the house.

That may appear to be a good deal, particularly for retirees who don't expect to be able to leave much to their heirs. Unlike an immediate sale, a reverse mortgage allows them to remain in their home, and it may be preferable to a home equity loan or line of credit that entails monthly payments.

For example, a 75-year-old homeowner, in a house worth $500,000, could borrow a lump sum of up to $241,540 through the federally insured Home Equity Conversion Mortgage (HECM) program, get the same amount as a line of credit that increases by 3.73% per year, or receive a monthly payment of $1,501 for as long as she lived in her home, according to a calculator on AARP.org.

Although the number of reverse mortgages has increased sharply during recent years, by the end of fiscal 2007 there were just 265,234 federally insured loans outstanding. Meanwhile, there were 30.8 million households in which one or more members was at least age 62 (the minimum for taking an HECM loan). That amounts to less than one loan for every 100 eligible households.

One problem is that many people who might benefit from a reverse mortgage know little about this loan product. But as understanding of these loans has increased, interest has actually decreased. In a 1999 study, only one in two respondents had heard of a reverse mortgage, and just 3% knew someone who had taken one. By 2007, those numbers had increased to 70% and 7%, respectively. Yet whereas in the earlier survey, 19% said they might consider a reverse mortgage in the future, by 2007 only 14% expressed interest.

In a 2006 study for the AARP—"Reverse Mortgages: Niche Product or Mainstream Solution?"—researchers Donald L. Redfoot, Ken Scholen, and S. Kathi Brown questioned both those who have taken reverse mortgages and those who considered a loan and received mandatory counseling about reverse mortgages before deciding not to borrow. Among the people who opted against this means of tapping home equity, more than 60% cited the high cost of reverse mortgages, while 57% said they wanted to keep their home debt free. 43% said they thought a reverse mortgage would make more sense in the future than it does now, while four in 10 said they would prefer to be able to pass along their homes free and clear to their heirs.

Many who decided against a reverse mortgage said they were leery of losing their last remaining asset to the high fees long associated with this kind of loan. And they have reason to worry. Consider this example, included in the AARP report, of the costs of an HECM loan for a 74-year-old borrower in December 2006. Her home was worth $300,000, and she qualified for a credit line of $180,800. If she took half that amount immediately then borrowed nothing more during the next 12 years (her expected life expectancy) while her home appreciated 4% a year, she or her estate would owe a total of $238,500, or about half the projected future value of the home. That debt includes accrued interest costs as well as an origination fee, mortgage insurance premiums, and servicing fees.

In the AARP survey, such costs were cited as the main reason for spurning a reverse mortgage—three times as often as any other factor. The authors conclude that if this kind of loan is to become more popular, competition will need to increase and fees will have to come down.

Reverse mortgages should be viewed as a last resort option for elderly homeowners, and interested parties should be informed on the fees and details of the transaction. We would be happy to meet and help you determine if a reverse mortgage is right for you. ●

rollover. To avoid the issue, instruct your plan to send funds directly to the new IRA.

3. Not rolling over sufficient funds. If you don't use a trustee-to-trustee transfer—say, you need to use the funds for 60 days—you must deposit the exact amount in the IRA that you received as a distribution. Any shortfall is subject to tax (plus a possible early withdrawal penalty).

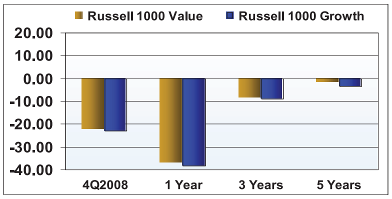
4. Making this an all-or-nothing proposition. You don't have to roll over your entire retirement account balance. If you need cash now, you could take a partial taxable distribution and transfer the rest to your IRA. Alternatively, to better manage the tax implications, you could transfer the entire amount and do a separate distribution from the IRA.

5. Rolling over to the wrong IRA. You can make a tax-free rollover only to an IRA you own. Mistakenly transfer the funds to your spouse's IRA or another account, and the distribution is taxable.

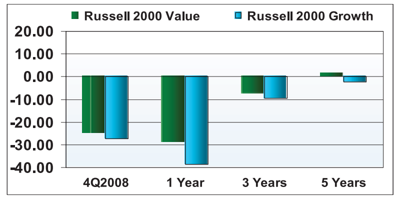
6. Making too many rollovers. A "rollover" is when you take possession of the funds before re-depositing them in an IRA. While you are allowed multiple "transfers" per year, you are only allowed one "rollover." Subsequent rollovers within the same year will be treated as a taxable distribution.

If you'd like our help in arranging a safe, tax-free rollover or transfer to an IRA, please give us a call.●

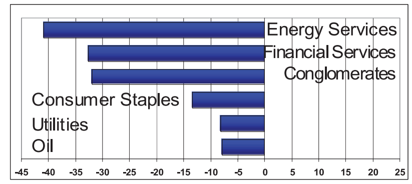
Market Data Bank: 4th Quarter 2008



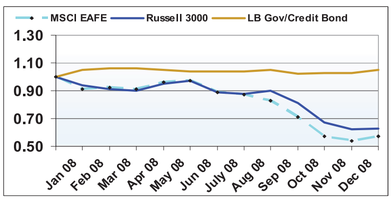
LARGE VALUE VS. LARGE GROWTH
Substantial declines for leading U.S. banks and oilfield services shares pushed large value- and growth-oriented stocks down roughly 22% in 4Q08; over the year, both lost 36% to 38% of their total worth.



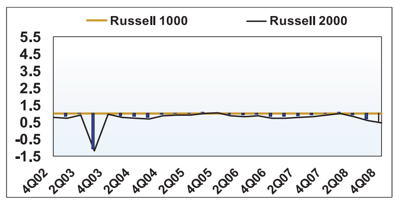
SMALL VALUE VS. SMALL GROWTH
Smaller banks and consumer-focused companies continued to outperform their growth-driven peers, but still ended down 24%. Over the last five years, only small value has held onto any gains at all.



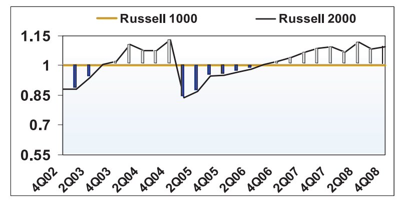
THREE BEST AND WORST SECTORS
All major industry groups suffered in the broad-based rout. Oil companies, utilities, and relatively defensive consumer staples manufacturers held up the best, but delivered substantial losses nonetheless.



FOREIGN, US STOCKS & US BONDS
Extreme aversion to all forms of market risk pushed government bond prices higher while punishing equities. In 2008, U.S. shares lost 37% of their value; foreign shares plunged a harrowing 43%.



LARGE VS. SMALL STOCK EARNINGS
The biggest companies managed to fatten their profits by 13.5% in 4Q08, but their smaller rivals found growth harder to find. Small-cap earnings growth slowed to just 5.9%, its lowest level in several years.



PRICE-TO-EARNINGS RATIO
As stock prices retreated, shares became somewhat cheaper to investors on a fundamental basis. Smaller companies fetched a higher price per dollar of earnings in 4Q08, continuing a two-year trend.

Small-cap stocks represented by Russell 2000 index, large-cap stocks represented by Russell 1000 index. Foreign stocks represented by the Morgan Stanley Capital International's Europe, Australia, Far East Index, and US bonds by the Lehman Bros. Government/Corporate Bond Index. P/E ratios exclude negative earnings. Small-cap stocks tend to be more volatile than large-caps. Bonds offer a fixed rate of return while stocks will fluctuate. Indices are unmanaged and do not represent any specific investment. Foreign investing involves special risks, including political unrest, economic instability, and currency fluctuation. Past performance does not indicate future results.

Source: Russell/Mellon

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 a financial professional 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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