

Financial Ink®

YOUR MONEY MANAGEMENT NEWSLETTER

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WILD RIDE OR QUIET STROLL?

The stock market has taken investors on a wild ride for the past several years. For example, a hypothetical portfolio of stocks mirroring the S&P 500 would have taken until 2006 to recoup losses sustained during the three-year bear market that began in 2000.¹

AND THE WINNER IS...

This illustration compares hypothetical \$10,000 investments in 10-year Treasury bonds and stocks mirroring the S&P 500 over 25 years.

	TREASURYS	S&P 500
Opening balance on 12/31/1981	\$10,000	\$10,000
Losses sustained between 12/31/1999 and 12/31/2002	\$0	\$80,148
Average annual return	7.2%	13.4%
Cumulative return	464%	2,204%
Ending balance on 12/31/2006	\$56,387	\$230,399

Source: Thomson Financial, 2007. The performance of an unmanaged index is not indicative of the performance of any particular investment. Individuals cannot invest directly in an index. Past performance is no guarantee of future results. Taxes and investment fees were not considered and would reduce the ending balance if taken into account.

Meanwhile, an investment in low-risk 10-year Treasury bonds wouldn't have lost a penny during the same time period — or at any time during the past 25 years (see table).

Looking back, it might seem as though the portfolio of Treasuries would have been the better investment. But there's more to the picture.

Dig Deeper

As you can see from the table, the return from stocks was more than *four times* greater than from Treasuries — in other words, the opportunity cost of playing it safe was almost \$175,000. Of course, remember that past performance is no guarantee of future results.

Risk — In this case, the return from stocks was worth the risk, but only for someone who had time to recover from losses sustained during the period. Your own risk tolerance is determined

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WORKING WITH YOU TO HELP ASSURE YOUR FINANCIAL SECURITY

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PREPARE TO CONVERT

In the past, only people with adjusted gross incomes of \$100,000 or less were eligible to convert their traditional IRAs to Roth IRAs. The Pension Protection Act of 2006 repealed this rule, but it doesn't take effect until 2010.

In another change starting in 2008, investors can make a direct rollover from an employer-sponsored retirement plan to a Roth IRA, treating it as a Roth conversion (income limits still apply until 2010). Fortunately, you have some time to decide whether a Roth IRA conversion would be an appropriate move for you.

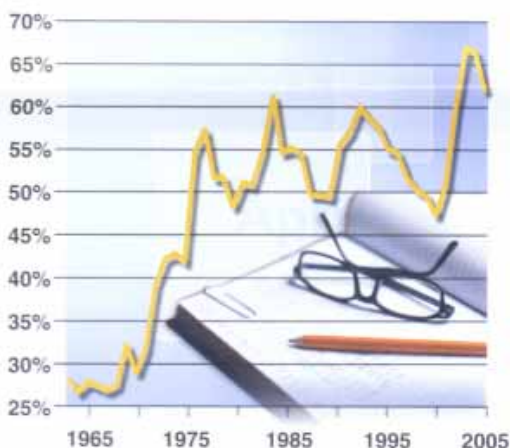
Probably the most popular reason for converting to a Roth IRA is the opportunity to receive tax-free withdrawals in retirement. Another benefit of a Roth is that there are no mandatory distributions during your lifetime.

Although a tax-free retirement income might sound too good to pass up, there are some trade-offs and drawbacks when converting a tax-deferred retirement account to a Roth IRA. Here are some factors to consider.



SPOKEN FOR

Some experts believe that the growth of mandatory entitlement spending will result in higher tax rates in the future. This graph provides historical data on mandatory entitlement spending as a percentage of federal tax receipts.



Source: Congressional Budget Office, 2006

Disappearing Deductions

A Roth conversion may make sense if you expect to be in a higher tax bracket in retirement, or if you expect tax rates to be higher in the future.

Consider this: By the time you are ready to retire, you may have little or no mortgage interest to deduct from your taxes. Your children will likely be grown and no longer your dependents for tax purposes. And you may not be making tax-deductible retirement plan contributions.

Taxes Today

A Roth conversion requires that you pay income taxes that have been deferred on qualified retirement plan assets. You can convert the funds all at once or over multiple years. The amount you convert in a given year is included in your gross income when you calculate your taxes. One drawback is that if you use funds from the original retirement account to pay the taxes before you reach age 59½, it would be considered an early distribution and would be subject to a 10% federal income tax penalty.

Of course, to qualify for a tax-free and penalty-free withdrawal of earnings, a Roth IRA must be in place for at least five tax years, and the distribution must take place after age 59½ or due to death, disability, or a first-time home purchase (up to a \$10,000 lifetime maximum).

TAX-FREE POSSIBILITIES

This time of year, "tax-free" probably sounds as good to a taxpayer as ice water sounds to a hiker lost in the desert. Research shows that 59% of people believe their taxes are too high.¹

In our society, just about any financial transaction has tax consequences. But you might be surprised at the potential tax benefits associated with owning life insurance.

Term Policies

An individual term life insurance policy remains in force for a specific period of time and pays a death benefit only if the insured dies during the term. A term policy cannot accumulate cash value and has no residual value if it is allowed to lapse. Although you typically pay the premiums with after-tax money, even this most basic of policies offers tax benefits.

- The death benefit paid to the beneficiary upon the death of the insured is not considered income and thus is not taxable.
- If the insured person does not own the policy, the death benefit is not considered part of the individual's estate for the purpose of calculating estate taxes.

- The death benefit can be used to help pay any estate taxes due on the estate.

Permanent Policies

A permanent life insurance policy offers a death benefit upon the insured's death, but it also has the potential to accumulate cash value during the insured's lifetime. In addition to the tax benefits already mentioned, permanent insurance has other potentially favorable tax consequences.

- Any premiums paid into the policy that are later withdrawn are not subject to income tax.
- Once all premiums have been withdrawn, the insured may be able to take loans against the policy's cash value. Because the money is borrowed, it is not taxable as income. Be aware that loans from a life insurance policy will reduce the policy's death benefit.

The cost and availability of life insurance depend on factors



such as age, health, and the type and amount of insurance purchased. Before implementing a strategy involving life insurance, it would be prudent to make sure that you are insurable.

As with most financial decisions, there are expenses associated with the purchase of life insurance. Policies commonly have mortality and expense charges. In addition, if a policy is surrendered prematurely, there may be surrender charges and income tax implications. Before you take any specific action, be sure to consult with your tax professional.

1) Tax Foundation, 2006

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in large part by your time horizon and investment objectives.

Treasury bonds are backed by the full faith and credit of the U.S. government as to the timely payment of principal and interest. The principal value will fluctuate with changes in market conditions. If not held to maturity, Treasuries may be worth more or less than their original value.

Inflation — Inflation for the 25-year period averaged slightly more than 3% per year.² That's almost half the average annual return from the bond

investment but less than one-fourth of the return from stocks.

It's impossible to forecast whether stock market volatility will continue, but it would be prudent to assume it will. However, the cost of playing it safe may be higher than you are willing to bear.

1) Thomson Financial, 2007, for the period 12/31/1981 to 12/31/2006. The S&P 500 is generally considered representative of U.S. stocks. The performance of an unmanaged index is not indicative of the performance of any particular investment. Individuals cannot invest directly in an index.

2) Thomson Financial, 2007. Consumer Price Index for the period 12/31/1981 to 12/31/2006.

TEST YOUR BOND KNOWLEDGE

A bond is simply a vehicle that enables governments and corporations to borrow money from investors. But that's where the simple part ends. Use this quiz to help increase your knowledge of bonds and the bond market.



- When you buy a bond, you are loaning money to the bond issuer with the expectation that you will receive _____ plus the return of your principal when the bond matures.
 - a tax deduction
 - interest payments
 - inflation
 - a thank-you note
- Once you buy a bond, you have to hold it until the maturity date to get your principal back.
 - True
 - False
- A bond issuer with higher creditworthiness typically pays _____ interest rates than an issuer rated as a higher credit risk.
 - lower
 - higher
 - more flexible
 - the same
- When interest rates are falling, an existing bond's value on the secondary market _____.
 - falls
 - rises
 - is unaffected
 - is irrelevant
- The possibility that a bond issuer will want to repay the bond before it matures is called _____ risk.
 - default
 - interest rate
 - call
 - reinvestment

Answers:

- b.** Interest payments.
- b.** False. You are free to sell the bond to a willing buyer. Whether you can sell it for more or less than you paid for it depends on a range of variables.
- a.** Lower. Bond issuers with a lower risk of default don't usually have to pay as much in interest as their riskier counterparts.
- b.** Rises, because it may be more valuable than a new bond.
- c.** Call risk is the risk that the bond issuer will "call" the bond when interest rates have fallen in order to refinance the debt. The bondholder will have to reinvest the principal earlier than expected, presumably at a lower interest rate.

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*Have you taken on an appropriate amount of risk for your situation to help meet your goals?
We can help you understand your risk profile.*

For help with your financial decisions,

Tom Lovell