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Asset Management / Comprehensive Financial Planning
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Boosting Your 401(k) Plan's Returns

Your 401(k) plan's ultimate size is primarily a function of two factors — how much you contribute and how much you earn. Of course, you know you should contribute the maximum amount possible ($15,000 in 2006 plus a $5,000 catch-up contribution for individuals over age 50, if permitted by the plan). But what steps should you take to maximize your returns? Consider these tips:

✔ **Take advantage of employer matching contributions.** Contribute at least enough to take full advantage of any matching contributions. You simply lose the money if you don't use it. A 50% match on your contributions is like boosting your return by 50% in the first year. If you plan to contribute the maximum and your employer matches contributions, have the $15,000 taken out of your pay uniformly throughout the year. Many employers match your contributions as they are made, so you could forego some matching if you reach the limit before year-end. For instance, assume you earn $150,000, your employer matches 50 cents per dollar on up to 6% of your pay, and you contribute 15% of your pay. After two-thirds of the year, when you have earned $100,000, you will contribute the maximum of $15,000, and your employer will have contributed $3,000. If you contribute 10% of your pay instead, your contributions will be spread throughout the year and your employer will contribute $4,500, an additional $1,500 match.

✔ **Select your investment alternatives carefully.** Since you are responsible for investment decisions, understand all alternatives and review all available information before making choices. Keep in mind the long-term nature of your retirement goal and select investments appropriate for that time period. For most participants, that will mean that a significant portion of their portfolio should be invested in growth alternatives, such as stocks.

✔ **Rebalance periodically.** Numerous studies have found that rebalancing reduces portfolio

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A Look at P/E Ratios

Price/earnings (P/E) ratios are a common measure of stock value, both for individual stocks and the overall market. Calculating a P/E ratio is straightforward — it is simply the price of a single share of stock divided by the company's per share earnings. For example, a stock selling at $50 per share with $2 per share of earnings would have a P/E ratio of 25.

The difficulty is deciding what a reasonable P/E ratio is for a particular company or for the overall stock market. For individual companies, investors' expectations about future earnings affect the P/E ratio. There is no absolute measure of what P/E ratio should be paid for a given company with a given growth rate. P/E ratios can fluctuate significantly over time and among companies and industries. It generally helps to follow the P/E ratios of stocks that interest you, along with companies in similar industries, to develop a feel for how the P/E ratios fluctuate. Reviewing a company's P/E ratio for prior years can also be helpful.

If you'd like help using P/E ratios to make investment decisions, please call. ❍❍❍

401(k) Plan

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volatility, often with increased returns. By rebalancing, you are following a fundamental investment principle — you are buying low (those investments that are underperforming) and selling high (those investments that are performing well). Keep in mind that you set your asset allocation strategy because you believed those were the appropriate percentages of various investments that you should own. Thus, you need to make rebalancing a habit so your portfolio doesn't become more risky than intended.

✔ **Limit the amount of company stock owned.** Purchasing too much company stock is risky. Not only is your job and livelihood tied to the company, but your retirement savings are also tied to the same company. It is generally recommended that any one stock not comprise more than 5% to 10% of your portfolio's value. If you own company stock in your 401(k) plan, look at how much of your total balance it represents. Take steps to immediately reduce that percentage if it is over 10% of your total portfolio.

✔ **Don't borrow from your 401(k) plan.** While it may be comforting to know you can gain access to your 401(k) funds when needed, only borrow as a last resort. It's true that you are borrowing from yourself and will pay interest to yourself, but there are also hidden costs to this borrowing. When you borrow, some of your investments are sold. While your loan is outstanding, you miss out on any capital gains or other income those investments would have earned. Interest rates are typically very reasonable with 401(k) loans, often prime rate or a couple of points over prime. That makes it easier to pay back the funds, but could mean your 401(k) account is earning lower returns than if it was invested in other alternatives. Also, if you leave the company while a loan is outstanding, you must repay the entire balance within a short period of time or the loan will be considered a distribution, subject to income taxes and the 10% early withdrawal penalty if you are under age 59 1/2 (55 if you are retiring).

Call if you'd like help with decisions involving your 401(k) plan. ❍❍❍

How Useful Are Financial Rules of Thumb?

Financial rules of thumb are designed to give you quick guidelines for your finances. However, you shouldn't follow them without giving some thought to your personal circumstances. Some of the more common financial rules of thumb include:

Save 10% of your gross income. While this will give you a good start, it's typically the minimum, not the maximum, you should be saving. Analyze how much you'll need for your financial goals, and then decide how much to save every year.

Plan on spending 80% of your preretirement income during retirement. This may be true if you don't plan to be very active during retirement, but more and more people expect retirement to include extensive travel and expensive hobbies. On the other hand, if you've paid off your mortgage and your children have finished college, you may need less than this. Review your individual situation.

Set the percentage of stocks in your portfolio to 100 minus your age. With increased life expectancies, this can result in your portfolio being too heavily weighted in income investments. Set your asset allocation based on your risk tolerance and time horizon for investing.

Keep three to six months of income in an emergency fund. While an emergency fund is a good idea, how much to keep in that fund will depend on your circumstances. You may need a larger reserve if you are the sole wage earner in the family, work at a seasonal job, own your own company, or rely on commissions or bonuses. A smaller reserve may be required if you have more than one source of income, can borrow significant sums quickly, or carry insurance to cover many emergencies.

Pay no more than 20% of your take-home pay toward short-term debt. Once considered a firm rule by lenders, you can obtain loans even if you exceed this amount. However, don't become complacent if you meet this rule of thumb, since a large percentage of your income is still going to pay debt. Try to reduce your debt or at least reduce the interest rates on that debt.

Keep your mortgage or rent payment to no more than 30% of your gross income. While you can obtain a mortgage for more than that, staying within this rule will help ensure you have money to devote to other financial goals.

Obtain life insurance equal to six times your annual income. Different individuals require vastly different amounts of insurance, depending on whether one or both spouses work, whether minor children are part of the family, or whether insurance is being obtained for other needs, such as to fund a buy/sell agreement or to help pay estate taxes. Thus, you should determine your precise needs before purchasing insurance. ❍❍❍

Consider a Conversion

In tax planning, the goal typically is to delay the payment of income taxes. Thus, it can be difficult to understand why it might make sense to convert a traditional individual retirement account (IRA) to a Roth IRA, which would result in the current payment of income taxes.

Factors that favor converting to a Roth IRA include:

✔ You can pay the income taxes due from the conversion with funds outside the IRA. By doing so, you are in essence increasing your IRA's value by the amount of tax paid. Amounts converted must be included in income if taxable when withdrawn (i.e., contributions and earnings in deductible IRAs and earnings in nondeductible IRAs), but are exempt from the 10% early withdrawal penalty.

✔ You expect your marginal tax rate at withdrawal to be equal to or greater than your current marginal tax rate. When your rates are equal at both times, the financial results from either IRA will be similar. Increasing income tax brackets generally make it advantageous to convert to a Roth IRA.

✔ You won't make withdrawals from the Roth IRA for a long time. Estimates indicate that you generally need five to 10 years of tax-free compounding to compensate for the current payment of taxes.

✔ You don't expect to take withdrawals from your IRA. Since you aren't required to withdraw funds from a Roth IRA, even after age 70 1/2, your IRA balance can continue to grow on a tax-free basis.

✔ You want to leave your IRA balance to heirs. With a Roth IRA, your heirs receive the proceeds free of federal income taxes. Also, if you don't withdraw funds from the Roth IRA after age 70 1/2, you could potentially leave your heirs with a much larger balance than from the traditional IRA.

Some factors that may indicate you should not convert to a Roth IRA include:

✔ You have to pay income taxes due from the conversion with IRA funds. The amount used for this purpose will be subject to income tax and the 10% penalty if you're under age 59 1/2.

✔ You expect your marginal tax rate when funds are withdrawn to be significantly lower than your current marginal tax rate. In this situation, you will typically experience better financial results by leaving the balance in your traditional IRA.

✔ You will make withdrawals after a short time. Thus, the tax-free compounding of earnings won't offset the current payment of income taxes.

✔ Income from the conversion would increase your adjusted gross income (AGI) to a level that increases your marginal tax rate or prevents you from using some tax credits, deductions, or exemptions.

✔ You expect to withdraw the majority of your IRA funds during retirement. Thus, the estate planning aspects of a Roth IRA are not of interest.

To convert from a traditional IRA to a Roth IRA, AGI for single taxpayers and married taxpayers filing jointly cannot exceed $100,000 in the year of conversion. This limit does not include any income resulting from the conversion. Also, starting in 2005, required minimum distributions from traditional IRAs are no longer included in the $100,000 limit. Amounts that have been rolled over from a qualified pension plan, such as a 401(k) plan, to a traditional IRA can also be converted to a Roth IRA. Once the balance is converted, qualified distributions cannot be made until after the five-tax-year holding period. Distributions before then are subject to the 10% early withdrawal penalty, unless one of the exceptions applies.

You do not have to convert your entire IRA balance. You can convert only a portion, which may help with the payment of income taxes.

Deciding whether you should convert an existing IRA to a Roth IRA will depend on a number of factors. Please call if you'd like help with this analysis. ❍❍❍

Financial Decisions for Your Children

When caught up in the day-to-day struggle of raising your children, it's easy to forget to take care of other financial decisions involving them, including:

✔ **Naming a guardian for your children.** If you and your spouse both die without naming a guardian in your will, the courts will appoint one and will supervise your children's property.

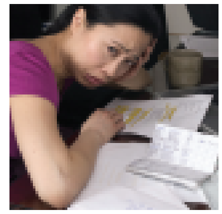
✔ **Purchasing sufficient insurance.** You should have enough life insurance to provide for your children until they are adults. Determine how much is needed for living expenses, hobbies, medical expenses, and college. Also ensure you have adequate disability income insurance, so your family's lifestyle won't be disrupted if you have an injury or illness.

✔ **Saving for college.** Determine how much you need to save for your children's college educations. Take a look at education savings accounts and section 529 plans.

✔ **Teaching money basics to your children.** In a society that has difficulty managing money, teaching your children good money skills is a lesson that will benefit them for a lifetime.

✔ **Saving for your retirement.** Don't feel guilty thinking about your own retirement when your children still need your help. One of the best gifts you can give your children is the knowledge that you will be financially independent during retirement.

✔ **Gifting assets to your children.** If you plan to leave assets to your children after your death, you may want to start making annual gifts during your lifetime. You can make annual gifts, up to $12,000 in 2006 ($24,000 if the gift is split with your spouse), to any number of individuals without paying federal gift taxes. You can then help teach your children how to handle those gifts and share in their joy from the gifts. ❍❍❍



Set Your Own Debt Limits

Credit can be a valuable tool that allows you to purchase major items and pay for them over time. But the ready availability of credit also makes it easy to incur more debt than you can comfortably repay. Rather than allowing lenders to set credit limits for you, evaluate your financial situation and determine your own limits.

Before purchasing something on credit, carefully evaluate whether it makes financial sense to do so. Some questions to ask yourself include:

✔ Should I wait and save the money so I can pay cash for the item?

✔ Will the cost of the item increase or decrease in the future?

✔ Is it really worth paying interest on the item so I can use it now?

✔ Will I still be within my designated debt limits if I add this new debt payment?

✔ Will the item still have value after I finish paying for it?

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Financial Thoughts

According to 2005 data from the Employee Benefit Research Institute:

✔ 25% of current retirees rely solely on Social Security.

✔ Less than 3% of taxpayers make contributions to an individual retirement account (IRA) every year, compared to 16% in 1986.

✔ If 401(k) plan participation continues at current levels, low-income workers can expect their 401(k) plan balance to replace 51% of their income, while high-income workers can expect it to replace 67% of their income.

✔ Approximately 20% of workers participate in defined-benefit pension plans, compared to 27% in 1984.

Another recent survey found that workers can expect to replace 59% of their income in retirement from all sources of income, including Social Security, pensions, and personal savings. Personal savings accounts for only 10% to 20% of the total (Source: *Journal of Financial Planning*, November 2005).

Approximately 13% of employers offered early-retiree health benefits in 2002, compared to 22% in 1997 (Source: Employee Benefit Research Institute, 2005). ❍❍❍