The Thoughtful Investor

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These are Interesting Times

The best part of a financial crisis are the new perspectives that arise as people look at where we have been and where we might be going. The information below is a collection of interesting insights. We're not sure where they will go, but we are looking forward to finding out the results.

■ The three decades after World War II saw the rise of the middle class, whose income gains outpaced the gains of the wealthy. One reason may have been the top marginal income tax rates, which ranged from 70 to 91%. Did the wealthy have less incentive to make money, or did the high tax rates reduce the amount of capital they had to invest in wealth building?

■ The recent period has been one in which considerable wealth was created not by the economy of producing and selling goods and services, but by selling assets back and forth. In the savings and loan crisis of the 1980s, institutions were selling commercial property back and forth to each other, marking a profit on each transaction, even though no actual value was added to the property. Much the same took place in a more esoteric manner with collateralized mortgage securities. If this was an

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Your Most Important Investment

If there is one single investment with the potentially highest payout, we would argue that it is maintaining a healthy body. All too often in the pursuit of financial health, we forget that we also need to invest in caring for our physical health.

Universal health care insurance, increased Medicare and all the benefits sought by health care legislation are only of value once health is broken. And, even with the best health care program, there can be no guarantees that medical intervention will restore your health or that poor health won't destroy your financial security. According to a 2005 study from Harvard University, medical bills trigger more than 50% of all bankruptcies, even when individuals have health insurance.

Exercise and a good diet are the first steps. If you are over weight, the most important change you can make to add longevity and comfort to your life is to lose weight. Being overweight can cause joints and back problems, acid reflux, sleep apnea, foot pain, and more, and contributes to carpal tunnel syndrome, diabetes, heart disease and some cancers.

While it would be nice to have perfect health habits, even minor changes in your behavior to get more exercise, eat better, etc., are better than none.

There's lots of help out there for finding what constitutes the right diet and exercise for your life. You just have

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Pay No More Taxes than Necessary

One of the most important rules of achieving and maintaining financial security is to pay no more taxes than required. Any time you can minimize or defer taxes you have more money to invest for retirement, education, a new business and so on. If you haven't already done so, you need to discuss the following with your financial adviser:

- Maximize tax-deferred and tax-free investments by contributing the maximum to qualified retirement plans and education savings plans.
- If you are in the 10 and 15% tax brackets you have a unique opportunity to fund a Roth IRA in terms of a 0% capital gains tax rate through 2010. Qualified investors can take a highly appreciated long-term investment, sell it at 0% capital gains and invest up to $5,000 per person ($6,000 if you are over age 50) in a Roth IRA. That could be up to $12,000 per couple.
- Starting in 2010, the existing $100,000 income test for converting a traditional IRA to a Roth IRA will no longer apply. You will be able to convert an IRA to a Roth IRA and pay income taxes on half the conversion amount in 2011 and the rest in 2012.
- Homeowners in areas hit by tumbling property values should appeal their tax assessments. Many homes were last appraised by counties prior to the housing crash.
- Track deductible expenses! Investment, medical, some educational expenses and more qualify as income tax deductions, although there are some minimums to be met.

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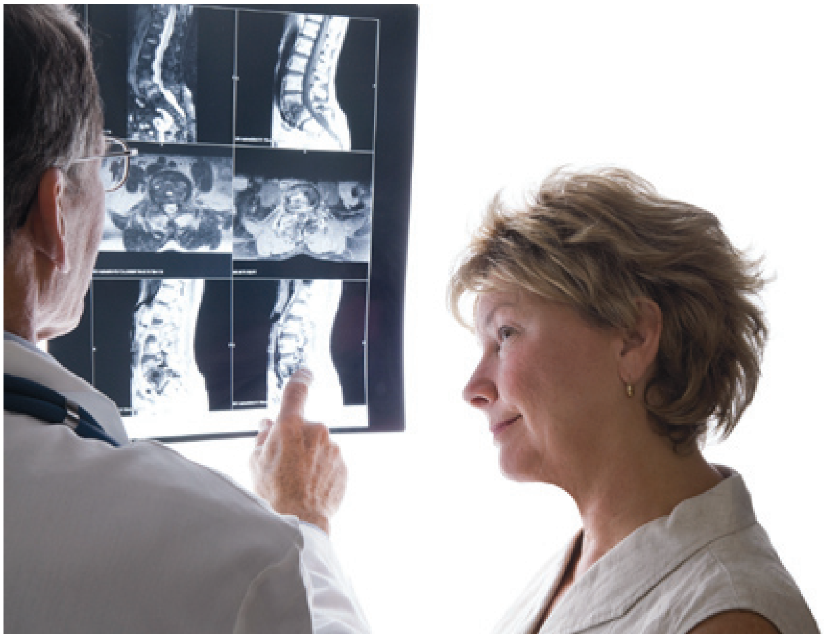

to set aside time to do the research and then follow through.

The next step is to take care of small problems before they become big problems. Medical issues are a lot like market declines. They rarely happen without signaling their onset. Getting regular health screens are a start, but you also have to pay attention to yourself.

Successful people often have difficulty admitting that they have problems, particularly when the problems seem minor. But when small problems are persistent and don't go away, find out why. Once you have a medical diagnosis, ask questions. Don't accept the doctor's opinion as the final word without confirmation. It's hard to forget the following doctor's quote. "Until we do the autopsy, we're just guessing." Your goal is to avoid the autopsy by making certain the "guesses" are as accurate as possible.

In all the posturing and position statements on providing health care for all, you can't afford to overlook the fact that you are the only one who can give yourself a healthy body. The medical professional can fix some problems, but all too often the root cause of the problems is the patient. The best health care coverage you can have is coverage you don't need.

Can You Trust the Caller?

Just when almost everyone has caught on to the fact that it's not a good idea to blindly respond to emails seeking personal information, phishers have turned our phones against us as well, with a twist. Now it's possible to get a call that Caller ID identifies as your bank that is actually fraudulent.

Through the use of Caller ID spoofing technology, phishers mimic a financial institution's numbers to fool Caller ID. A typical scam informs the phone user that the person's bank account has been compromised or credit card/ATM card has been deactivated. The potential victim is directed to call a number or go to a spoofed Web site to reactivate the card. There the potential victim is asked for card, account numbers and PIN numbers or other information that can be used to drain the account or post fraudulent charges.

Avoiding fraud is a simple matter of contacting your bank, credit union or credit card issuer directly, using numbers and web sites found on your card back, statements and other documents. "Trust no one, assume nothing" may seem like a harsh way to face the world, but when it comes to protecting your financial security it's good advice.

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abnormal period, where do we go from here?

- Bull or bear? According to historical data and a still struggling economy, we may be in a cyclical bull market in a secular bear market, says Tom Lauricella in a June 15, 2009 *Wall Street Journal* article, "Is This Bull Cyclical or Secular?" If he is right, the market's run up in the second and third quarters is a temporary respite in a longer-term bear market.

- If you are feeling poorer, you are not alone. Net worth of American households (difference between assets and liability) at the end of 2008 was down nearly 18% from 2007, according to the Federal Reserve. Net worth fell another 2.6% in the first quarter of 2009, according to Fed data. Household liabilities are also on the decline, falling 2% in the fourth quarter and 1.2% in the first quarter of 2009.

- There's a lot of money sitting on the sidelines. According to ICI statistics, there was in excess of $ $3.6 trillion in money market mutual funds in mid August 2009. That is nearly 24% of the value of U.S. equities, estimated at around $15.2 trillion.

What this will mean to your investments remains to be seen, but with active management, we have the flexibility to respond to changes. And that can make all the difference.

Paying for a College Education

One of the big reasons for saving is to enable your children, or your grandchildren, to attend college. The caution is that **you should never** finance your children's higher education at the expense of funding your retirement. There are a lot of ways to finance a college education from loans to scholarships, work study programs and more. Your resources for retirement are very limited. There are no loans, grants or scholarships to retire. In the end it comes down to what you have accumulated.

With that said…what are some of your options when it comes to paying for a college education?

One year of tuition, room and board at a public university averages $14,333 for in-state students; $25,200 for out-of-state students according to 2008-2009 data from the College Board. Private universities average $34,132 per year. Textbooks can add another $800 to $1,000 a year. For more information on specific universities in your area, visit the schools' web site.

To pay that cost, you have five primary resources:

(1) Savings.

(2) Student loans.

(3) Grants/Financial aid.

(4) Scholarships.

(5) Work study programs.

Which of these resources you will have access to is going to depend, to a degree, on your family's financial status. The more money you have, the fewer the resources for which you will be eligible. The exception is the 529 plan, where everyone is eligible and the contributions are substantial (more than $300,000 per beneficiary in many state plans).

In this article, we look at vehicles for college savings, but the following are some very informative web sites on the other four resources. http://www.college.gov/ and http://studentaid.ed.gov are great starting points for student loan information. At https://studentaid2.ed.gov/getmoney/scholarship/ you can search for scholarships by area of study. http://www.ed.gov/programs/fws/ offers a look at federal work study programs that offer part-time employment to offset post-secondary education costs.

529 plans are state-run with assets professionally managed either by the state treasurer's office or by an outside investment company hired as the program manager. Although contributions are not tax deductible, investments grow tax-deferred, and distributions to pay for the beneficiary's college costs are federally tax-free.

Types of 529 plans

529 plans are usually categorized as either prepaid or savings plans.

Savings Plans work much like a 401K or IRA by investing your contributions in mutual funds or similar investments. The plan will offer several investment options from which to choose and will go up or down in value based on the performance of the particular options selected.

Prepaid Plans let you pre-pay all or part of the costs of an in-state public college education. These plans may also be converted for use at private and out-of-state colleges. The Independent 529 Plan is a separate prepaid plan for private colleges.

Many states offer incentives to their residents to use the state's plan, but you can invest across state lines in plans offered through other states. Just make certain you understand how those plans will be treated with respect to your state income taxes.

Contributions to **Coverdell Education Savings accounts** are limited to $2,000 a year and are not deductible. But earnings are tax free if used to pay college costs or expenses for elementary and secondary school education including private and parochial schools. To contribute to a Coverdell your adjusted gross income must be under $110,000 if you are single or $220,000 if you are married and file a joint return.

Roth IRA. Direct contributions to a Roth IRA (not including rollovers) may be withdrawn at any time with no tax or penalty, since they have already been taxed. Over ten years, for example, parents could contribute up to $100,000 ($5,000 each annually) to Roth IRAs, and then withdraw the principal to pay college bills. Earnings would continue grow tax free in the account. These would be eligible for tax free withdrawal after a minimum five years and when the accountholders reach age 59 ½.

IRA withdrawals for education. A taxpayer under age 59½ can avoid the 10% penalty on early IRA distributions used to pay higher education expenses for his or herself, a spouse or a dependent. However, the payout from a traditional IRA is taxable at your personal income rate.

Savings bond interest. Interest on Series EE savings bonds bought after you turned 24 can be excluded from income if the proceeds are used to pay college costs for yourself, your spouse or a dependent, if you meet adjusted gross income qualifications.

Don't overlook the value of simply building your own financial net worth. After all, very few wealthy people can't afford to send their children to college.

Investigating Business Associates Has Never Been Easier

If you have never investigated the backgrounds of people you hire, contract with or entrust with your financials, before you enter into any new relationships, you might want to do so. At the center of this recommendation is a tough economy. In bad times, fraud increases.

Deciding against a relationship because your gut said something was wrong is often a good start to avoiding problems. But you can't stop there when it comes to deciding who to trust. Really good con men or women are professionals at gaining trust and projecting a worthy exterior. Even with a great referral, changing circumstances in the individual's life could impact their behavior. Many people never intended to embezzle money. It was just a short term, unauthorized loan that they were going to repay as soon as they got back on their feet.

The reason they get away with the fraud is often because there is no system in place to detect the problem until it is too late. This is why it is so important that your funds are held not by the individual providing you with investment advice, but in your name with an independent custodian who provides regular account statements. Next, you need to read those statements as soon as they arrive.

Your best bet in deciding whether or not the exterior presented by the individual is real is to look at their past behavior. While it's nice to believe that people can change, in tough times, they often revert to what has rewarded them in the past.

Even if an investigation doesn't turn up criminal actions, be wary of signs of irresponsible behavior. Disregard for motor vehicle laws, alcohol-related issues, a poor credit history, frequent job changes or just moving around a lot may indicate problems and provide insight to a person's character.

Doing your own investigation

Start with an internet search for the individual's name enclosed in "quote" marks so results include only that specific name, not parts and pieces of the name. Use middle initials. If their name is a relatively common one, include the city and state where they live or have lived. The internet can also help you access the following databases:

- Better Business Bureaus throughout the country now have online complaint databases.
- If the individual is in a business that requires state registration, search online records to verify whether or not the individual or business is registered and in good standing.
- Try a reverse look up on phone numbers to find out who owns the phone number and where it is registered. Does the information match that given by the individual?
- If you have an address, search on Google Maps or Mapquest and look at the satellite or street image. If it turns out to be a post office box or an unlikely location, that's a red flag.
- If you know the county the individual lives in or has lived in, check the county records for title records, liens, mortgages, bankruptcies, marriages, divorces, etc.
- Business networks such as Linked-In may provide education and past job history information on the individual. Use that information to contact schools and employers.
- Criminal convictions are a matter of public record and can be found in the county clerk's records, although these records are typically not available online.

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RETURN SERVICE REQUESTED

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