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REGISTERED INVESTMENT ADVISOR
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FINANCIAL MANAGEMENT UPDATE First Quarter 2007

Dow ends first quarter down slightly, rest of market is flat.

By: Chas P. Smith, CPA/PFS

Sources: Investor's Business Daily, Yahoo Finance, Bloomberg.

Index performance numbers for the first quarter are in: The Dow Jones Industrial Average, made up of 30 blue chip stocks, fell 0.87% for the quarter. By comparison, the S&P 500 rose just 2.73 points or 0.18%, while the Nasdaq Composite gained 6.35 points, which translates to a mere 0.26%. After all that volatility, the first quarter ended flat.

Of course it didn't feel that way, given the spiking volatility and dramatic headlines. In retrospect it seems the bull market is still intact, despite recent reports of its imminent demise. Optimism held through the first quarter even as stocks posted the biggest weekly drop since 2003 in the period ended March 2nd. They retreated as much as 5.9 percent from the S&P 500's six-year high on Feb. 20.

1st Quarter's wild ride depicted below:



Stocks are the cheapest they've been in 20 years, relative to bonds. Profitability of companies in the Standard & Poor's 500 Index, (the benchmark for American equity), is growing faster than shares, and represents a yield of 6.53 percent compared with 4.65 percent for 10-year U.S. Treasury notes.

The gap -- the widest since 1986, according to data compiled by Bloomberg -- has encouraged investors because earnings forecasts indicate the U.S. will keep growing, while bond yields reflect confidence that inflation will stay in check.

What to do:

What should you do to address this volatile and uncertain period? Take a longer view than focusing on a three-month period!

Do not fret over uncontrollable, unpredictable, and irrelevant headlines.

What happens over the next 2-6 quarters will have no effect on the 28th year of your 30+ year retirement.

Do not join your neighbors' panic when headlines scream about 100-point swings in the Dow Jones Industrial Average and other market gauges. Allow your long term vision to prevail.

Many assume that big price swings benefit rapid-fire traders who, if they catch the right wave, can score big in just a day or two. The problem is that for each trader who catches the right wave there's another one catching the wrong side. In volatile but overall flat markets, trading is a zero-sum game.

Sticking to a regimen of investing a set amount at regular intervals, as most folks do with their 401(k) or other automatic-investment accounts, you can be a certain winner.

Consider a stock or mutual fund in which you invest \$100 a month at a starting price of \$20 a share. After one month, the price is \$25, a month after that \$10, then \$30, \$15 and, finally, right back at \$20, where

it stays for a month. The price swings may give you the jitters and seem especially intolerable given that after six months, in this example, you have ended up right where you started: \$20.

Yet because you invested \$100 each month, and thus were accumulating shares while the price was down, you would have ended up with 34 shares at an average price of just \$17.65, and would be up by the annual equivalent of 27%. That's the magic of steady investing, also known as dollar-cost averaging. You automatically buy more shares when prices are low and fewer when they are high, driving down your average cost per share. The bigger the price swings the better. Volatility can be a good thing—if you can stick to your long-term plan.

Thinking about dropping that old life insurance policy?

By: P. Jill Ashley, CPA

Sources: Wall Street Journal Online

Sometimes your original intent for purchasing an insurance policy no longer applies. You may have experienced changes in your family or beneficiaries, no longer have the risk exposure, or escalating premiums have become cost prohibitive. If this is the case, a life settlement may provide an appropriate “exit strategy.”

A life settlement is the sale of an existing life insurance policy (term, whole life, universal and others) to a third party company for cash. Typical candidates for life settlements are insureds over age 65 with some health problems owning a policy with a face value of \$250,000 or more. Policyholders must have a life expectancy between 2 and 17 years.

The buyers are typically investment firms that, after purchasing the policies, continue to pay the premiums and collect the benefit when the original holder dies. Obviously, it's in the buyers' interest to keep the purchase price low. Buyers also prefer the insured died sooner rather than later; a policy covering an individual with declining health, or an active smoker, could be worth more than a comparable policy on a healthy individual.

Historically, the process for “cashing-out” policies involved surrendering the policy to the insurance company and receiving the accumulated savings

component. Today, investors may buy that policy for considerably more -- three or four times more than the cash surrender value -- but less than the net death benefit. In some circumstances, they also will buy “term” policies which pay death benefits, but lack a savings component.

Once you sell the policy, the life settlement company then becomes the new owner of the policy, pays the future premiums and collects the full benefit upon your death.

Rather than walk away from an unwanted policy allowing it to lapse – or turning it in for a meager cash surrender value, ask your financial advisor if a life settlement is appropriate for you.

An appropriate life settlement can free up substantial amounts of cash that may be better utilized elsewhere in your financial portfolio.

Tips:

Shop it: How much you can get for your policy will vary, depending on several factors including your age, medical condition or life expectancy, the type of insurance policy, the premium costs, the rating of the insurance company and the value of the policy. Obtain bids from several brokers or life settlement providers to be sure you are getting the best deal.

Also, find out what fees or costs you'll be required to pay. From the purchase price a number of fees are deducted, the largest of which is usually the broker's commission. It is extremely difficult for sellers of a policy to know whether they're getting the best deal possible.

Tax and privacy issues: Your medical history can be widely shared among many parties. The payout from a life settlement might lead to a big taxable event and affect Medicaid (not Medicare) eligibility. (In contrast, at a policyholder's death, life-insurance benefits paid to heirs are income tax-free.) Life settlements are taxable to the extent the proceeds from settlement exceed the premiums paid. Consult your tax advisor.

Fraud protection: Life settlements have been drawing the attention of regulators due to aggressive sales tactics. Life settlements are not regulated in

every state, so be careful who you're dealing with. Make sure the life settlement company or broker you choose is either licensed in your state or is a member of LISA.

Questions have been raised about collusion among buyers and brokers. Last October, former New York Attorney General Eliot Spitzer filed suit against one of the largest life-settlement buyers, Coventry First, accusing the firm of bid-rigging with one of its competitors that significantly short-changed investors.

In this alleged scheme, Coventry would make payments to brokers in exchange for them tilting the bidding process to ensure that Coventry was able to purchase the policies at lower prices. Emails presented as evidence showed Coventry officials haggling with brokers over what Coventry would have to pay to win the auctions. In one instance, Coventry is alleged to have paid a broker \$200,000 in exchange for not presenting to the policyholder a bid that would have topped Coventry's bid on a \$10 million policy by \$425,000. Coventry denies in court filings that the firm did anything wrong, saying it didn't have to disclose the payments to policyholders.

Ask for a full accounting of what bids were received and what steps were taken to shop it around. In addition, it's important to ask if the broker is affiliated with a particular life-settlement company and thus may only be getting a bid from that one firm. Don't be afraid to ask a lot of questions.

In the end, there may be other more attractive options, such as exchanging your policy for another insurance offering that better suits your needs.

Other Considerations:

There may be other options that should be considered. If it's a question of not being able to afford the policy premiums, ask your insurance agent if you have any cash value in your policy that can help with the payments. If so, you may be able to use some of the cash value to meet your immediate needs and keep your policy for your beneficiaries. You also may be able to use the cash value as security for a loan, or ask if family

members/beneficiaries wish to contribute to the premiums.

Find out if your life insurance policy has an accelerated death benefit, paying some of the policy's death benefit during life.

Congratulations your 2006 tax return is complete, but what can it tell you?

By: Lee Burrows, CPA/PFS
Sources: IRS.gov

With tax filing season still fresh on your mind, cast an analytical eye over your return to see whether proper planning can make the next tax filing more palatable.

Focus on these line items:

Line 7: Wages, Salaries, Tips, Etc.

Review your W-2 for the year, which will show if you maximized your retirement-plan contributions. The maximum for 2006 was \$15,000 for a 401(k) (\$20,000 if you're over age 50). Make sure you take maximum advantage for 2007: You can contribute up to \$15,500 (\$20,500 if you're over age 50). By increasing your retirement contribution, you will lower your AGI (adjusted gross income). By lowering your AGI, you may be eligible for more tax-planning opportunities like converting part or all of a traditional IRA to a Roth IRA.

Lines 8a and 8b: Taxable and Tax-Exempt Interest

If you are in the 28% marginal tax bracket or higher, try to minimize taxable interest. You can invest in tax-exempt money markets, and your bond investments can also be tax-exempt. Take a closer look at Schedule B to see exactly which investment vehicles are contributing taxable interest and consider repositioning your portfolio this year to put more emphasis on tax-exempt investments. Ask your financial advisor if you are maximizing tax efficient interest income strategies.

Line 28: Self-Employed SEP, SIMPLE, and Qualified Plans

If you are self-employed and you didn't take the \$44,000 maximum deduction for 2006, ask your CPA how to increase that number for 2007. (The maximum deduction this year is \$45,000).

Line 37: Adjusted Gross Income (AGI)

AGI represents an important threshold you can plan around. Your AGI determines whether you'll lose any itemized deductions or exemptions, whether you can contribute to or convert to a Roth IRA, and whether you can deduct miscellaneous and/or medical expenses.

Itemized Deductions

Married couples reporting more than \$10,300 in deductions in 2006, (or singles reporting \$5,150 deductions) probably filed Schedule A to itemize each deduction. Married couples filing jointly who had AGI exceeding \$150,500 in 2006 started to lose these itemized deductions via phase-outs.

For 2007 the standard deduction for married taxpayers filing jointly is \$10,700 (\$5,350 for singles). The phase-out point is \$156,400 (\$78,200 for married couples filing separately).

Personal Exemptions

The personal exemption amount for 2007 increased from \$3,300 to \$3,400 per person. For married couples filing jointly in 2006, if your AGI exceeded \$225,750 (\$150,500 for singles), you lost 2% of your exemption for each \$2,500 your income exceeded the limit.

For 2007 planning purposes, the threshold for married taxpayers filing jointly is \$234,600 (\$156,400 for singles).

The good news is that these phase-outs are shrinking by one third in 2006 and 2007--a phase out of the phase out (can someone pass the aspirin?).

Medical Deductions

In order to take medical deductions, they must exceed 7.5% of AGI.

Miscellaneous Deductions

You can deduct miscellaneous deductions as long as they exceed 2% of AGI.

Roth Conversions

If AGI is over \$100,000, you can't convert a traditional IRA to a Roth IRA (this restriction is slated for removal in year 2010).

Lines 43: (Taxable Income) and 63: (Total Tax)

Divide Line 63 by Line 43 and you'll calculate your "effective" tax bracket. This is the true measure of how much of your income you're giving up to tax.

Roth IRA Contributions

If AGI is more than \$166,000 in 2007 (for married couples filing jointly; that figure is \$114,000 for singles), you are not eligible to contribute to a Roth IRA. (The same is not true of contributions to a Roth 401(k), which has no income limitations.) If AGI is between \$156,000 and \$166,000 for married couples, there is a phase-out of how much you can contribute to a Roth. (That range is \$99,000 to \$114,000 for singles.)

Your 1040 Federal Tax Return can be the single most important source of relevant information for use in many areas of personal financial planning. So it pays to take time analyzing those numbers with your financial advisor.

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