

Personal Wealth Report

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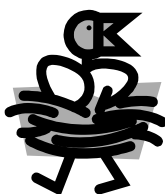
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Money Management

Two Sound Principles to Invest By

It is well known that there are no guarantees in the investment world. Nevertheless, you may take steps to improve the possibility that you will be successful over time and reduce the potential for a financial disaster. How? By relying on two widely used investment techniques: diversification and asset allocation.



Diversification and asset allocation are often confused with one another or considered to be the same concept. In actuality, they are two separate investment principles that can

work together hand-in-hand.

However, we must remind you that there are no absolute guarantees. Even if you utilize sound investment principles such as diversification and asset allocation, you are not completely protected against an overall loss. Here is a closer look.

Diversification is the concept of mixing a variety of investments within an individual's portfolio. Say you have invested 100% of your liquidity in your company's stock—you spread out your investment dollars among different types of investments. Therefore, you may minimize your overall risk, since you are not totally dependent on the market fluctuations of just one investment.

Diversification means more than just buying several different stocks. Within one investment category, you might acquire several stocks from different industries. Furthermore, you might increase the level of diversification through foreign investments.

Asset allocation is a similar but distinctive investment principle. Essentially, it is the process of dividing assets among major categories such as stocks, bonds and cash. Typically, the allocation is made on a percentage basis. Since each class has a different level of return and risk, it is expected that the classes will behave differently over time. Selecting the proper allocation of assets for your portfolio is a *(continued on page 3)*

Insurance Ideas

Face the Facts About Disability Concerns

Have you ever considered what would happen to your family if you were to be disabled for a lengthy

period of time? Even if you are in the best of health right now—and we hope that you are—there are no guarantees that will continue. In fact, the odds of being disabled at some point in your life are downright alarming.

Just take a look at statistics provided by the U.S. Census Bureau Report of 2000. For instance, a 45-year-old male worker is more likely to be disabled than he is to die before reaching

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Tax Talk

How to Deduct Investment Interest Expenses

If you have borrowed money to make investments in, say, stocks, bonds or mutual funds, you may be able to deduct "investment interest" expenses. The critical tax question is: How much interest, if any, is deductible? There is no easy answer.

For starters, only the interest attributable to investment purposes qualifies for the deduction. If you take out a loan to buy a new car for nonbusiness driving or finance a vacation, the resulting interest is nondeductible. Those are purely personal expenses. If the loan is made partially for investment purposes and partially for personal reasons, you must make an allocation based on the appropriate percentage.

Next, the qualified interest may be



deducted only up to the amount of your net investment income. This is your investment income reduced by investment expenses other than interest. Investment income includes such items as interest, dividends, royalties, gains from sales of investment property and income from annuities. For purposes of this tax law limit, investment expenses are income-producing expenses that are allowable deductions after applying the 2% limit on aggregate miscellaneous itemized expenses. Some income-producing expenses that are potentially deductible before the 2% limit is taken into account include fees for investment advisory services and safe deposit box rentals (for investments other than tax-exempt securities), just to name a couple.

However, net long-term capital gain generally does not count as invest-

ment income for purposes of the investment interest deduction, unless you make a special election.

How it works: You can include long-term gain in your net investment income computation, but you must reduce the gain eligible for the maximum capital gain rate by the same amount. Under the 2003 tax act, the maximum long-term capital gain rate has been reduced to 15%. Therefore, there is a lesser incentive to make this election now than there was in the past. Nonetheless, consult with a tax professional with respect to your personal circumstances.

Other tax rules, such as limits on passive activities, may also come into play. These rules are complex, so be sure to get professional tax advice.

Retirement Review

Should You Fly Solo on a 401(k)?

If you are self-employed, you probably do not have a 401(k) plan. After all, there are other retirement plan alternatives, such as SIMPLEs (Saving Incentive Match Plans for Employees) and SEPs (Simplified Employee Pensions), which are easier to maintain. However, recent tax law changes provide added incentives for a self-employed individual to set up a "solo" 401(k).

Background: A 401(k) plan is a tax-deferred way for employees to save money for retirement. In the usual situation, an employee defers part of his or her salary to a separate account through regular payroll deductions. The employer may also agree to match these elective contributions in whole or in part (e.g., 50 cents on the

dollar).

These pre-tax contributions may accumulate in the account without any tax erosion. Distributions are taxable as ordinary income when they are withdrawn, but the employee is generally in a lower tax bracket at that point. A 10% penalty tax generally applies to distribution before age 59½. Finally, there are strict contribution limits (including a dollar limit for elective deferrals) and nondiscrimination requirements.

Major changes: Prior to the 2001 tax act—the Economic Growth and Tax Relief Reconciliation Act (EGTRRA)—the effective limits on annual contributions often discouraged high-income individuals from establishing a solo 401(k) plan. The 2001 tax act boosted these limits with provisions for inflation adjustments in subsequent years. For 2004, the limit on overall de-

ductible contributions made on behalf of an employee has been increased to the lesser of 25% of compensation (up from 15% before the 2001 act) or \$41,000. The maximum amount of compensation that may be taken into account for this purpose is \$205,000.

There is also a dollar cap on the amount of elective deferrals permitted with a 401(k) plan. The dollar limit (\$13,000 for 2004) is increasing

gradually until it will reach \$15,000 for 2006 and thereafter. Furthermore, individuals age 50 or over will be allowed to make special "catch-up" contributions to a 401(k). The allowable catch-up contribution (\$3,000 for 2004) also

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Contributions are completely discretionary. If your business is having a bad year, you can reduce or suspend contributions

Two Sound Principles to Invest By (continued from page 1) difficult proposition. It should reflect a number of factors, including your investment objectives, age, state of health and ability to assume risk. Your objectives may change over time so the allocation of assets should be adjusted, taking current economic and market conditions into account. As conditions change, you should reevaluate your current holdings.

Note: Diversification does not eliminate risk, guarantee a profitable investment return or guarantee against a loss. But it can be a useful technique that can reduce overall portfolio risk and volatility.

Combining diversification with asset allocation can be an effective 1–2 punch. Your professional advisers can help you determine the proper mix of investments.

A Red-letter Day for SIMPLE Plans

Simplicity can be a beautiful thing. It is one of the main attractions of the aptly named SIMPLE retirement plan (short for Saving Incentive Match Plans for Employees). This is a relatively easy way for a small-business owner to establish a qualified plan for his or her employees. To qualify, the business cannot have had more than 100 employees who earned at least \$5,000 of compensation during the preceding tax year.

There are two basic types of SIMPLE plans. One is structured like an IRA and the other is comparable to a 401(k).



Alert: A key deadline is fast approaching. Unlike other qualified retirement plans, your business has until October 1, 2004 to set up a SIMPLE plan for 2004. The maximum amount that an employee may contribute is \$9,000 (plus an additional \$1,500 for someone age 50 or over).

Estate Analysis

When There's a Will, There's a Way

What happens if you pass away without having a legally enforceable will? Your assets will be distributed according to your state's intestacy laws no matter what your real intentions may have been. This could work to the detriment of a spouse or children or other heirs—especially if you have been married more than once.

A will may include provisions designed to avoid unnecessary estate tax. It can be used to appoint a guardian for minor children, name an executor of the estate and establish domicile—just to name a few of the common objectives.

Here are some basic guidelines for drawing up a will.



1 Do some preliminary work regarding your assets and your designated beneficiaries. This ground-

work will ensure that the resulting will is a complete and accurate document.

Typically, the will may refer to some or all of the following assets:

- >Cash and bank accounts;
- >Securities such as stocks, bonds and mutual funds;
- >Principal residence and any other homes;
- >Investment real estate;
- >Automobiles and boats;
- >Artwork, jewelry and other valuables;
- > Safe deposit box contents; and
- >Business interests and assets.

2 Determine who gets what. A will enables you to control which individuals will get which particular assets. After taking inventory of your assets, write down who your benefi-

aries will be and what types and amounts of property you wish to pass along to each one.

Consider various trusts and similar arrangements that can ensure that certain assets are passed along with tax benefits or other considerations in mind.

3 Keep your will up-to-date. For example, you may have written a will more than ten years ago. At that time, you were satisfied that the will was complete in every way. But now circumstances may be such that your old will no longer affords you the protection and flexibility it once did.

Should You Fly Solo on a 401(k)? (continued from page 2)

increases gradually until reaching \$5,000 for 2006 and thereafter.

Finally, employee deferrals will no longer count towards the aforementioned percentage cap on compensation (25% for 2004). Since a self-employed individual is essentially both the employer and the employee, this provides a distinct advantage for establishing a solo 401(k).

A few other potential advantages of a solo 401(k) are:

* Contributions are completely discretionary. If your business is having a bad year, you can reduce or suspend contributions.

* The plan may permit loans and hardship withdrawals if necessary.



* The plan can accept rollovers from another qualified plan or an IRA.

In summary: Solo 401(k) plans have become more prevalent in recent years. Although the paperwork isn't nearly daunting as it used to be, this is still a complex area. Consult with an experienced benefits planner.

Give Us A Call!

Do you have any questions or comments about **Personal Wealth Report** or your individual situation? Please don't hesitate to contact our office. We would be glad to serve you in any way that we can.



Face the Facts About Disability Concerns (continued from page 1)

retirement age. The odds are greater than 50-50 that he will suffer a severe disability before age 65. According to the report, almost 50 million Americans live with disabilities every day.

Nevertheless, a recent survey, jointly conducted by the Consumer Federation of America and the American Council of Life Insurers (2001), found that 82% of the people in this country have no long-term disability income insurance or believe that their current coverage is inadequate.

Word to the wise: It is time to take adequate steps to protect your family. One possible solution is to take out a private disability income insurance policy to complement any employee policies you already have. With a private policy in your pocket, you can help pay the monthly bills and provide some income for your

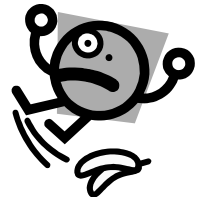
family to fall back on if you are disabled for a lengthy period of time.

Is that all there is to disability income insurance? Not quite. Before you sign on the dotted line, you have to make sure that you obtain the type of coverage that best suits your needs. Some of the key features of a disability income insurance policy that deserve your close attention are:

- >Length of coverage;
- > Amount of benefits;
- > Requirements for receiving full benefits;
- >Definition of disability;
- > Cost-of-living adjustments;
- > Availability of partial benefits;
- >Length of waiting period; and

>Non cancellation features.

Finally, the cost of the premiums is certainly a factor to consider. For instance, a policy that pays out benefits for your lifetime is likely to be more expensive than one where the benefits end after ten years. You must weigh the cost against the risks involved for your family.



Of course, there are numerous options and variations available. Your financial service professional can help you determine which type of disability income insurance policy, if any, is right for your situation.