

Diversified Asset Management, Inc.

1113 Spruce Street, Boulder, CO 80302

phone: 303-440-2906

Now's A Time To Recall Financial Planning Basics

Just a few years ago, almost everyone knew at least one person who had made a fortune in the stock market. Today, many of us have lost a fortune. For those who are wondering what went wrong, here's a refresher course in financial planning basics.

Diversification.

In the late 1990's, many investors thought diversification meant buying three computer stocks and two Internet stocks. Others assumed they were being prudent

because they owned a dozen mutual funds. But true diversification means buying a range of investments in markets that do not move in lockstep with each other. Through most of the 1990s, growth stocks were the spectacular performers; in recent years value stocks have been successful. A balanced portfolio will have both. It will also include bonds. But just starting out with the right mix isn't enough; you also need to rebalance your portfolio regularly, trimming positions that have done well and adding to others that may be poised to rebound.

Planning. Establishing clear life goals and a long-term strategy is the essence of sound financial planning. A solid plan lays out the amount you must save annually, assuming an expected average rate of return, to reach your financial targets. It prepares you for future expenses, such as a child's college education, and unexpected

setbacks, such as premature death or disability.

Saving. Money doesn't grow on trees, but it does grow provided you invest it. The more you put aside and the longer you allow it to compound, the better off you'll be. The rule of 72 is the easiest way to see how this works*. Simply divide 72 by your rate of return to get the number of years it will take for your money to double. For example, with an 8% return, your investment will



double in nine years and quadruple in 18. A steady, automatic withdrawal from your paycheck is probably the most effective way to save. That way, you don't miss the money, because you never see it, and you're able to load up on assets when they're doing poorly and reap the benefits when they go up.

Retirement contributions. The government rewards savers by offering tax benefits to retirement accounts such as 401(k)s, 403(b)s, and IRAs. In most cases, you contribute pre-tax dollars and the money grows tax-deferred, meaning you don't owe taxes on gains until you withdraw the money. With Roth IRAs, you contribute money that has already been taxed but your withdrawals are tax-free. Either way, the boost from Uncle Sam is so generous that it's worth stuffing as much as possible into retirement accounts before allocating to regular savings and taxable accounts.

(Continued on page 4)

Your Referrals Are Appreciated Now More Than Ever

It's relatively easy to succeed as an investor—or as a financial advisor—when the stock market is humming and all is right with the world. But during times like these, when the economy goes into a tailspin, the value of smart decisions and good advice really makes itself felt.

We appreciate the trust you've placed in our firm by remaining committed to a long-term investment plan. Savvy investors realize that the stock market often rises and falls with prevailing economic conditions, and that keeping the faith in basic investment principles is likely to provide favorable results. Your investment plan is designed to have staying power, to take advantage of trends that, over time, have favored investors who don't waver in the face of adversity.

Not long ago, much financial "advice" consisted of "hot" tips that were supposed to lead to a quick killing but could just as easily mean big losses. Today, many investors want a different kind of help, based on proven wealth management techniques that can help reach retirement goals without excessive risk. That approach, along with clear and constant communication, is the cornerstone of our partnership with you.

We are heartened and energized by your referrals to our firm. Now, more than ever, it's important to do things the right way, and we're committed to helping all of our clients, old and new, achieve their financial objectives.

Sincerely,

Robert J. Pyle, CFP, CFA

Ensuring A Smooth, Smart IRA Rollover

When retirement finally beckons and you begin to tap the funds in your 401(k) or other retirement plan, you can expect to give the IRS its share—at ordinary income tax rates as high as 35% of any withdrawal. But if you don't need the cash immediately, a better option may be to transfer the money to an individual retirement plan, or IRA.

A properly executed rollover to an IRA postpones current tax on the funds you transfer and keeps the money growing tax-deferred. (You can do this when changing employers as well as at retirement.) Eventually, you must make taxable withdrawals, but not until the year after the year in which you turn age 70½. It's also possible to transfer money from an existing IRA to another IRA, to get a better menu of investments, say, or to consolidate accounts.

Though making a successful rollover isn't difficult, several pitfalls could lead to unnecessary taxes. Avoid these six common mistakes.

1. Not meeting the rollover deadline. The tax law requires you to complete a rollover within 60 days of receiving funds from your cashed-out retirement plan. Otherwise, the distribution is fully taxable on the current year's return, and you could

face a 10% penalty for a premature withdrawal if you're under age 59½. That could get pretty expensive—50% or more of the value of your account when you consider federal and state taxes along with the 10% federal penalty and possible state penalties.

2. Not arranging a trustee-to-trustee transfer. Unless you make other arrangements, your company's retirement plan administrator will impose 20% income tax withholding on a payout, even if you intend to meet the 60-day deadline. Though you may recoup the money when you file your taxes, you'll have to come up with the cash before then to complete a tax-free rollover. To avoid the issue, instruct your plan to send funds directly to the new IRA.

3. Not rolling over sufficient funds. If you don't use a trustee-to-trustee transfer—say, you need to use the funds for 60 days—you must deposit the exact amount in the IRA that you received as a distribution. Any shortfall is subject to tax (plus a possible early withdrawal penalty).

4. Making this an all-or-nothing proposition. You don't have to roll

over your entire retirement account balance. If you need cash now, you could take a partial taxable distribution and transfer the rest to your IRA. Alternatively, to better manage the

tax implications, you could transfer the entire amount and do a separate distribution from the IRA.

5. Rolling over to the wrong IRA. You can make a tax-free rollover only to an IRA you own. Mistakenly transfer the funds to your spouse's IRA or another account, and the distribution is taxable.

6. Making too many rollovers. A "rollover" is when you take possession of the funds before re-depositing them in an IRA. While you are allowed multiple "transfers" per year, you are only allowed one "rollover." Subsequent rollovers within the same year will be treated as a taxable distribution.

If you'd like our help in arranging a safe, tax-free rollover or transfer to an IRA, please give us a call.●



A Walk Every Day Can Keep Aging At Bay

It's much easier to talk the talk about staying young than it is to walk the walk. Starting in our 20s and 30s, we commence a long, seemingly inevitable physical deterioration. Our maximum heart rate declines, and with it the amount of oxygen-bearing blood the heart can pump. Muscle is gradually replaced with fat and weight edges upward. And decade by decade, as oxygen intake drops, it becomes a little harder just to get around. Eventually, in our 70s, 80s, or 90s, most of us lose our "functional independence," the ability to live on our own. We move to assisted-living or nursing homes

because, literally, our living needs to be assisted.

But what if there were a simple way to turn back the clock? In a recent article in the British Journal of Sports Medicine, Roy Shephard, a physician at the University of Toronto, reports that for people 64 and older, a vigorous, hour-long walk five days a week cuts a dozen years from their biological age. In a review of other published work on the subject, Shephard found that such an exercise program could also extend a person's functional independence, which tends to be lost when maximal oxygen intake

falls below 18 milliliters per kilogram per minute in men and 15 ml/kg/min in women.

Without this kind of exercise program, about 10 years of physical aging normally corresponds with a loss of about five ml/kg/min. But Shephard found that beginning a program of vigorous aerobic exercise could restore about 25% of maximal oxygen intake within three months, raising that essential level by an average of six ml/kg/min and decreasing biological age by 12 years.

Shephard also found that regular exercise provides other benefits, helping prevent conditions that may

Solutions To Problems Second Families Often Face

A “blended” family with children from more than one marriage face an array of financial problems and choices that a traditional family never has to consider. The complications that come into play when there are children from one or two previous marriages and many sets of parents and grandparents can be daunting. Ex-spouses, remarried or not, only increase the complexity and financial challenges.

Studies show that blended families are less likely to have a clear idea of retirement goals and more likely to have problems saving enough money for retirement. Those who get past these stumbling blocks may encounter another hurdle—how to ensure an estate is distributed according to their wishes and equitably addresses all of the competing interests.

Suppose you want to make sure your children from an earlier marriage receive benefits from your estate. Or you may even hope to provide financial assistance to your in-laws from a first or second union. You could simply leave those responsibilities in the hands of your current spouse, bequeathing everything to her and trusting she’ll be equitable in carrying out your intentions. Yet she could easily choose another course, spending all of the money, directing it to her own parents or children, or remarrying and giving to her surviving spouse.

Here are three common estate-planning situations blended families may face, with possible solutions for handling the complications.

Take preemptive action. You are about to marry for the second (or third) time, and you want to ensure that your children from a prior marriage inherit some portion of the considerable assets you are bringing into the new marriage. The most effective way to accomplish that is to forge a prenuptial agreement (also known as a premarital agreement or antenuptial agreement) with your spouse-to-be before the wedding.

A “prenup” can include any provisions that both of you agree should be in it. It could state that the assets each of you bring to the marriage will remain your property, to be distributed however each of you sees fit if either spouse dies or you divorce. You could use a prenup to set aside an inheritance for your children. Keep in mind that in most states, if there’s no prenuptial agreement, your new spouse will have “spousal elective share rights” upon your death. This means the surviving spouse will be entitled to claim a certain percentage of your property, with the proportion typically determined by how long you were married. A prenuptial agreement can waive the normal provisions of state law or restrict them to certain types of property.

Close the barn door. Suppose you’re

already in a second marriage and there’s no prenup, yet you want to protect assets from a future claim by your current spouse. A post-marital or postnuptial agreement could accomplish the same purpose as a prenup. Postnups, honored in all states, specify each spouse’s rights and responsibilities in case of divorce or death. As with a prenuptial agreement, both spouses must reveal all of their property and assets and must sign the agreement, and that may be an issue, particular if the marriage isn’t going well. If a spouse can prove he or she was coerced into signing, the document may be invalidated.

Spread the wealth. A prenup or postnup isn’t the only way to make provisions for your current spouse while also seeing to it that your estate benefits your children from a prior marriage. A QTIP (qualified terminable interest property) trust can be an effective way to head off issues that may arise if you simply leave all of your assets to your current spouse and assume she’ll carry out your wishes. Though you and your spouse may agree now on how your property will be distributed, things could easily change after your death. Your spouse could remarry, and that new husband or wife may want a share of the estate. There’s also the chance your spouse could mismanage the estate and squander the money.

A QTIP trust can provide lifetime income for the surviving spouse while mandating that the trust assets ultimately go to your children, typically after the death of the surviving spouse. A trustee, who can be your spouse or someone else, is responsible for managing the money and making distributions according to the terms of the trust.

Another alternative is an irrevocable life insurance trust, or ILIT. The trust owns an insurance policy on your life, and the death benefit, which goes to the trust, will be distributed according to your instructions specified in trust documents. For that matter, a plain old life insurance policy can assure a benefit to children of a prior marriage—ILITs can perform a host of specific things, but if you just want your kids to get something, you may not need a trust. ●

hasten aging including obesity, high blood pressure, diabetes, heart disease, osteoporosis, and even some kinds of cancer. And the improved muscle tone that comes with brisk walking, swimming, or other aerobic activities may help older people avoid falls.

Another study, from Texas, further highlights what exercise can do. In 1966, five healthy 20-year-olds were kept in bed around the clock for three weeks—and suffered many of the ills normally associated with aging. They gained



weight, their heart rates and blood pressure rose, and their hearts lost pumping capacity. Then, an eight-week exercise program more than reversed the effects of inactivity.

In a follow-up with the men 30 years later, actual aging had imitated the effects of the forced bed rest. But here, too, an endurance exercise regimen undid most of the damage, restoring all of their lost aerobic capacity.

The moral? Exercise always helps, and it’s never too late to start pushing back the hands of time. ●

To Consolidate Your IRAs Or Not To Consolidate

Although this dilemma isn't as life altering as Hamlet's, it could still have a significant impact on your financial affairs. Here are several reasons to consider one path or the other.

When not to consolidate. While it's generally possible to consolidate multiple traditional or Roth IRAs—that is, merging traditional IRAs with other traditional IRAs, or Roths with other Roths—you can't put a traditional IRA with a Roth, and you can't join an IRA with employer retirement plans such as 401(k)s or 403(b)s.

One reason not to consolidate accounts is that it may mean forfeiting favorable tax treatment. For example, you're not permitted to commingle funds when you've rolled over retirement plan assets inherited from a non-spouse—those must remain in a separate inherited IRA. (You can, however, merge an IRA left by your spouse into your own account.) Or you may have assets in a "conduit IRA," a special kind of account that holds money from a previous employer's retirement plan until you can move it to a plan at your new job. To preserve the advantages of a 401(k) or 403(b)—for example, being able to tap

the account at age 55 if you retire early, or getting better tax treatment for company stock—you must avoid mixing a conduit IRA with other accounts.

You may also not want to consolidate if the IRAs have been separated to accomplish specific planning goals involving beneficiary designations or to set up specific streams of income.

When to consolidate. If none of those reasons apply, bringing together two or more accounts may provide several benefits. Almost all of the advantages involve the fact that it's much easier to manage one account than to keep track of several. Consider the following:

- Making changes in your investment strategy—say, moving to a more conservative mix of assets as you approach retirement—is significantly more complex and time-consuming if it involves several accounts.

- If you have many accounts, you may tend to ignore those that are small or

aren't performing well.

- If your IRAs are at several institutions, each one may charge you an annual maintenance fee. You'll also have more paperwork, with multiple monthly statements and end-of-year tax forms.

- When it's time to begin distributions from a traditional IRA—the year after you turn 70½—the amount of the required withdrawal is

based on the total value of all IRAs. Neglect to include one in your calculations and you'll face punishing tax penalties.

- Before consolidating IRAs, consider rolling over your 401(k) plan to an IRA so that you can "stretch" the IRA over a beneficiary's life expectancy. If a 401(k) participant dies before doing this, beneficiaries are generally required to take a full distribution and pay income taxes on it within five years.

We can help you decide if you should consolidate your IRAs and consider how those assets fit into your overall financial plan. ●



Financial Planning Basics

(Continued from page 1)

Tax planning. Hidden within hundreds of pages of tax laws are a broad range of special breaks for taxpayers. Shifting income from one year to another, selling assets that have lost money to balance out gains from top performers, and making contributions to educational savings accounts are just three possibilities. Review your tax situation with a financial professional at the beginning of the year and again in December.

Insurance. Planning for the unexpected is the key when determining insurance needs. You should have enough life insurance to meet heirs' long-term needs. Your health insurance should include coverage of

catastrophic accidents or illnesses. Disability insurance is relatively inexpensive, but could make a big difference if you need it. And you should seriously consider long-term care insurance if you don't think your retirement income will be sufficient to pay for nursing home care.

Estate planning. Having the right estate plan will ensure that your wishes are respected. If you have substantial assets, developing a well-thought-out estate plan can minimize taxes even while you are alive and maximize the amount you are able to leave to loved ones and your favorite charities. Even if you don't have enough in your estate to be liable for federal or state estate taxes, having a valid will can save your heirs a lot of trouble and money.

In the dying days of the 20th

century, there was talk about how the old financial rules no longer applied. "It's different this time," everyone said. But it wasn't all that different, and millions of investors lost ground and time on the road to their financial goals. It's never fun to start over, but it does give you one more chance to do everything right. Taking care of these basics should prepare you well, and we are happy to help. ●

***The Rule of 72 is hypothetical and there can be no assurance that any investment will double within the specified timeframe.**