

FINANCIAL BRIEFS

Fulton Financial Planning, Inc.

Spring 2005

Helping You Chart a Brighter Financial Future



Deidra Fulton, President

5068 W. Plano Pkwy, Suite 227
Plano, TX 75093

Phone: 972.248.3807

Fax: 972.248.3811

www.FultonFinancialPlanning.com

df@FultonFinancialPlanning.com

Providing

Hourly, As-Needed
Financial Planning and
Advice . . . The New
Choice for Smart
Consumers™

Member



The Garrett Planning Network, Inc.



All content Copyright © 2005
Fulton Financial Planning, Inc.

This newsletter strives to provide factual and up-to-date information on the topics discussed, but it should not be regarded as a complete discussion of these issues. The reader is advised to engage the services of a competent professional before taking action on any subject matter discussed.

Sage Advice from Mr. Buffett

Warren Buffett, chairman of Berkshire Hathaway, Inc., has a large, devoted following. His investing strategy is fairly basic: keep it simple, don't speculate on high-flying 'maybes' and invest in what you know and understand.

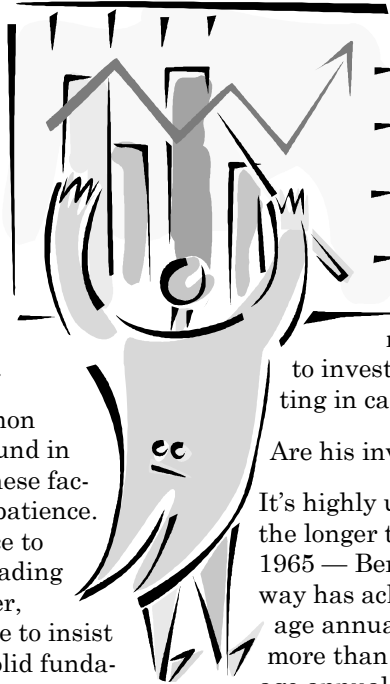
In his widely read annual letter to shareholders of Berkshire Hathaway, Mr. Buffett identified 3 factors that frequently lead to investor missteps. High costs lead this list, often because investors trade excessively or spend too much on management fees.

The second contributing factor is poor decisions, based on tips and fads rather than solid research. And lastly, he cites untimely exits from

investment positions, usually after periods of stagnation or decline.

A common trait found in all of these factors is patience. Patience to limit trading turnover, patience to insist upon solid fundamentals — and yes, earnings! — and patience to stick with a long-term plan.

Mr. Buffett also apologized to his shareholders



for the company's under-performance this past year. The reason: he could not find enough of the right businesses with solid fundamentals in which to invest his billions sitting in cash reserves.

Are his investors upset?

It's highly unlikely, for over the longer term — since 1965 — Berkshire Hathaway has achieved an average annual gain of 21.9%, more than double the average annual return of the Standard & Poors 500 during that same time.

Clearly, following sound principles and having patience pays handsomely. •

What's New at FFP?

The new year has already been very busy!

We've recently re-located our office to an even more convenient location.

Our **new address** is 5068 W. Plano Pkwy, Suite 227 in Plano, which is immediately west of Preston Rd. Please note our **new telephone number**: 972.248.3807.

And in celebration of spring's arrival, our **website** also has a fresh appearance.

We hope you will find the expanded content informative. We've kept some of the popular features, such as links to helpful web resources. And we've added some new features, such as news articles and a recommended reading

list. Take a look around the updated site for yourself.

And please visit often again in the future to view updated content.

Both of these changes will help us better serve our customers.

Give us a call or stop by and say hello. •

Go Easy On Home Equity Loans

Homeowners are unlocking the equity built up in their homes like never before. But before opening the home equity loan door, make sure you don't overextend yourself and put your home at risk.

With home values climbing dramatically in many regions in recent years, homeowners have piled up record amounts of home equity based loans. Last year alone saw an increase of 35% in these types of loans, according to SMR Research Corp., a business and market research firm. Homeowners are tapping their equity so heavily that credit card companies are feeling the competition and are also getting into the home equity loan business. And traditional lenders of home equity loans, such as banks and credit unions, are providing various incentives to encourage people to borrow against their home.

The most popular type of home equity loan these days is the home equity line of credit — HELOC for short. HELOCs operate much like the line of credit in a credit card. The lender determines the maximum amount you can borrow against the equity in your home. You can borrow any amount up to that limit and the interest charges apply only to the amount you borrow. Rates typically are around the prime lending rate, which was 5.5% in February 2005.

Say the line of credit is \$30,000 and you borrow \$4000, leaving \$26,000 available for additional borrowing later. The interest charges are based only on the \$4000, not the \$30,000 credit limit, just as they would be on a credit card. You might borrow \$4000 today, pay part

of it back, then borrow \$7500 a few months later. Flexibility is the key with HELOCs.

And just as credit card interest rates fluctuate, so do interest rates on HELOCs. Lately, after record lows, those rates have risen as the Federal Reserve has raised short-term interest rates.

That's where the second type of home equity loan comes in: the fixed-rate home equity loan. Here, you take out a fixed amount at a fixed interest rate and make fixed payments for a specific loan period, much as you would with an automobile loan. Fixed-rate home equity loans typically run 1 to 3 percent higher than HELOCs. But while short-term rates have climbed lately, longer rates have held steady, shrinking the gap between the 2 types of loans.

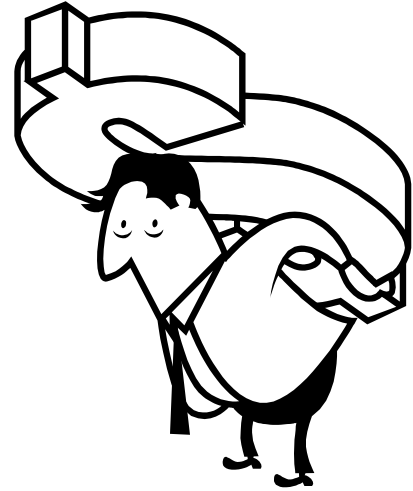
Beyond their relatively low rates compared with credit cards, home equity loans offer the added advantage of a tax deduction for the interest on loans of up to \$100,000.

(Taxpayers subject to the alternative minimum tax can deduct the interest only if the loan is used to buy, build or re-model their home.)

We typically recommend that the line of credit

loans be used for shorter-term, fluctuating needs, such as college expenses or perhaps emergency funding for unreimbursed medical bills. The idea with these is to pay off the loan fairly quickly.

The fixed-rate loans tend to be better suited to longer-term needs requiring a fixed amount, such as major home remodeling, but which you can't pay off for a while. They also are often used to consolidate and pay off higher interest, nondeduct-



ible debt, such as credit cards and auto loans.

The question of whether to use such loans for investing is a bit trickier. We generally advise against taking out a home equity loan and using the proceeds to invest in the stock market. It may be appropriate for a small number of households to use home equity for investing in real estate. And loans for home improvement that can add value to the home are also often wise choices.

Keep the risks in mind, whichever type of home equity loan you consider and for whatever purpose.

The biggest risk is that you can lose your home if you can't make the loan payments. In the case of a line of credit, rising interest rates could make it even more difficult for households who are already financially squeezed. A decline in home values could also put a loan in jeopardy.

Another risk is that some homeowners treat HELOCs like credit cards, using them for frivolous spending.

Of special concern is a homeowner who uses a HELOC to pay off non-deductible debt, such as credit cards, only to turn around and start using the cards again, thereby ignoring the root cause of the spending issues. •

The number of home equity loans increased 35% in 2004.

Some IRA Beneficiaries More Favored

Designating beneficiaries for various types of property is an important part of one's estate planning. The process enables you to specify who you wish to receive your interest in certain property at your death. Aside from directing the disposition of your property, there's another significant benefit. Making beneficiary designations means the proceeds can then pass directly to the intended recipient, in most cases, without having to go through the probate process or encounter other possible delays in completing the transfer.

Most of us would welcome news that we are a beneficiary. Yet some types of beneficiaries may have a distinct advantage over others by virtue of receiving more favorable treatment. So it pays to consider your beneficiary designations carefully and within the context of your overall estate planning wishes.

Let's briefly consider the process of naming beneficiaries for your traditional IRA. In general, the types of beneficiaries that receive more tax-favored status with these IRAs are a younger individual, a surviving spouse or a charity.

Naming a younger person as your IRA beneficiary means she will be able to use her own life expectancy when determining required minimum distribution amounts, thereby ensuring that a payout remains available over a longer time.

Naming an individual older than you, on the other hand, accelerates the payout amounts, thereby depleting funds more quickly, since that person's life expectancy is typically shorter than yours.

Naming your surviving spouse as the IRA beneficiary is also a wise move, because he or she can take the inherited IRA and roll all or even part of it over to their own IRA. This strategy offers additional

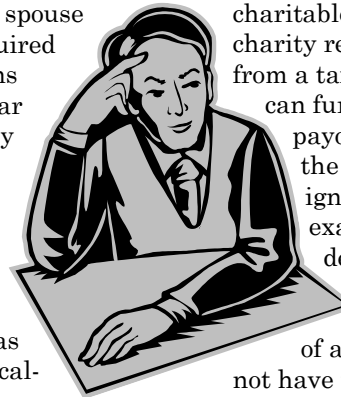
advantages, since the spouse may delay taking required minimum distributions until April 1 of the year following the date they reach age 70 1/2.

Once the spouse begins taking those distributions, he or she can use the same, more favorable table as the original owner in calculating the annual required minimum distribution amount. In addition the spouse can name a new beneficiary to receive proceeds at his or her death; the new beneficiary can again establish a new life expectancy based on his own age when calculating the required minimum distribution payouts at a later date.

Naming a trust which holds the IRA for the benefit of a spouse as a beneficiary loses that tax-favored status. The trust would not be eligible to pursue an IRA rollover. Rather, the best treatment the trust could receive would be to take money out of the IRA over the spouse's life expectancy. And tax rates for assets held by trusts (other than grantor trusts) are significantly higher than those that apply to individuals.

Leaving a traditional IRA to a qualified, public charity also offers tax-favored status, due to the charity's tax-exempt nature. In fact this strategy may be especially appropriate when the donor wishes to benefit a charity and is seeking tax efficiency in asset distribution. Plus the strategy may solve other estate planning issues.

For example, let's say a donor wishes to leave \$500,000 that's presently held in a traditional IRA to his favorite public charity. Rather than leave directly to the charity solely via beneficiary designation, he decides to accomplish another goal by also creating a



charitable remainder trust. The charity receives the proceeds free from a tax liability. The trust terms can further specify an annual payout of, for example, 5% of the overall proceeds to a designated individual. In our example, let's assume that designated individual is a favorite aunt of the donor. She gets the benefit of a lifetime income and does not have to worry about dealing with the minimum distribution requirements of an IRA. Plus the donor gets a tax deduction for his estate.

This example illustrates a much more efficient use of funds held in a retirement account than if the donor had relied upon assets held in non-tax deferred accounts to accomplish the same goals.

Conversely, leaving an IRA directly to your estate is generally not preferable because such a move forfeits the life expectancy payout possibility. At your death any proceeds would then become payable immediately, thereby potentially greatly increasing the tax liability owed. And remember that proceeds distributed from a traditional IRA are considered as ordinary income — just like wages or salary — and typically taxed at a higher marginal rate than capital gains or dividends.

Of course, naming beneficiaries for your ROTH accounts also reduces the time required for completing the transfer to your heirs. Unlike traditional IRAs, however, tax considerations and distribution rules are not primary issues with ROTH accounts since most withdrawals are tax free and they have no mandatory distribution requirements.

Make sure your beneficiary designations accomplish the goals that you want. Give us a call if you would like assistance in reviewing your own designations more closely. •

Assessing Social Security Today

We all look forward to the time when we can begin receiving social security benefits. Yet the future of this entitlement program leaves many unanswered questions.

Over a shorter horizon, fortunately, near-retirees can find helpful data as they consider their options today.

Earnings Limit. In 2005 the social security earnings limit is \$1000 per month or \$12,000 per year for individuals between age 62 and full retirement age (FRA) who are receiving benefits. One dollar for every 2 will be withheld for each dollar that you earn over the limit. For individuals who reach full retirement age this year, the earnings limit increases to \$2650 per month or \$31,800 on an annual basis. There is no limit on earnings for the following year and beyond after an individual reaches FRA.

Begin at 62? Should you begin receiving social security benefits at age 62 or wait until your FRA? In general, the longer you delay drawing benefits, the greater your risk of dying before the total from the larger, later payments catches up with

that of the smaller, earlier payments you could have elected. To calculate your crossover point, take your projected monthly benefit at both age 62 and at FRA, add the monthly cumulative total during your life expectancy (about age 84 to 86), then find the month when the cumulative benefit either equals or exceeds the early retirement benefit. At this crossover point you will have collected roughly the same amount under either retirement age. Also carefully consider your family's longevity and your personal health issues, as you evaluate the likelihood that you will survive beyond the crossover point.

Tax Impact. Part of your social security benefits may be taxable if your modified adjusted gross income (MAGI) exceeds certain thresholds. The formula for determining MAGI is based on "combined income," which is the sum of a taxpayer's AGI plus non-taxable interest, plus one-half of his or her social security benefits.

Up to 50% of social security benefits may be taxed if the combined income for a single taxpayer is be-

Social Security Facts

- The average person needs to save at least \$230,000 to draw \$1,000 a month to supplement social security benefits.
- Under the present format the estimated average social security benefit will be about \$955 a month.
- Relying upon social security as the sole or primary source for retirement income will typically mean that individual will end up with poverty-level incomes in their retirement years.

tween \$25,000—\$34,000; the threshold is \$32,000—\$44,000 for joint combined income.

Up to 85% of social security benefits may be taxed if the combined income for a single taxpayer exceeds \$34,000; the comparable threshold for joint combined income is any amount that exceeds \$44,000.

These income thresholds are not presently indexed for inflation. •

By the Number\$. . .

41 . . .
Percentage of income for recent retirees that comes from Social Security versus 24% from pensions and 11% from self-directed retirement accounts. (Putnam Investments)

1.8 . . .
Dividend yield for the S&P 500 around January 1, 2005. (The Wall Street Journal)

41 . . .
Percentage of the S&P 500's total return from 1926 through 2004 accounted for by dividends. (WSJ)

2524 . . .
Average cost, in dollars, per month in 2004 for assisted living, versus \$2379 in 2003. (Met Life Market Survey)

192 . . .
The average daily cost, in dollars, of a private room in a nursing home, up 6.1% in the last year. (MetLife Inc.)

80,000 . . .
Number of the over 112,000 defined-benefit pension plans terminated since 1985. (U.S. News & World Report)

Top Reasons to Get Financial Check-Up

- Clarify competing goals
- Secure objective, independent advice
- Adopt cost effective solutions
- Obtain road map for reaching financial goals
- Achieve better financial health
- Ensure a secure retirement
 - Gain peace of mind

Call 972.248.3807 to schedule yours!