

FINANCIAL BRIEFS

Fulton Financial Planning, Inc.

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Helping You Chart a Brighter Financial Future



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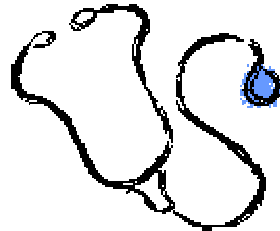
This newsletter strives to provide factual and up-to-date information on the topics discussed, but it should not be regarded as a complete discussion of these issues. The reader is advised to engage the services of a competent professional before taking action on any subject matter discussed.

The Annual Check-up

You hear the reminders all the time: visit with your doctor at least annually for a check-up and get regular screenings, as appropriate for your age. Medical experts state those are important steps for maintaining health.

Just as with your physical health, the annual financial check-up is key to staying on track for reaching your financial goals. Yet it's easy to downplay its significance.

Why is this annual financial review so important? It provides an opportunity to measure a client's progress against their plan of action. It's also a time for discussing changes that typically occur within any 12 month period, such as the birth of a child, the loss



of a loved one, a job change or a major purchase. Events such as these may then prompt a needed modification in the client's financial plan — or may re-affirm that the existing plan remains viable.

Indeed lives are seldom static, and that's why financial plans are not necessarily set-and-forget documents. But what does an annual meeting involve?

Typically the planner will examine a client's progress against their finan-

cial plan's timeframes. This monitoring benefits both the client and planner. Clients have an opportunity to step back from their busy lives, review goals and assess whether current priorities remain the same as when the plan was originally developed. Planners also have an opportunity to affirm the client's positive action towards goal achievement or to help them re-focus on stated goals before they get too far off track.

Many clients find that an annual review is sufficient, yet others may prefer meeting on a quarterly or semi-annual basis. Regardless of frequency, short term goals are typically reviewed during this meeting. Sometimes changes to a client's investment portfolio may be

(continued on page 4)

A Painful Payout?

Investors who own shares of Fidelity Magellan mutual fund probably got a big surprise recently.

And that surprise may be especially painful if shares are held in a taxable account.

That's because the mutual fund paid out more than 18% of its assets in May in the form of a spe-

cial distribution.

The per-share distribution was comprised of 25¢ in dividends and \$22.11 in long-term capital gains, for a total of \$22.36. An investor who owned 200 shares of the Magellan fund in a taxable account, for example, would have received \$50 in dividends and \$4472 in long term capital gains.

Fidelity acknowledges the pay-out was unusually large, but also adds that it was the result of the fund's new manager, Harry Lange, re-shuffling the investments within the portfolio in an effort to improve performance.

So what's the fuss? While distributions are great since they represent earnings,

(continued on page 4)

Disability Insurance

Here's a startling fact: your chances of being disabled for over 90 days are greater than your chances of dying prematurely.

In fact, it's not even close. One in 8 people will become disabled (meeting the more restrictive Social Security definition) in a given year versus 1 in 106 who will die early.

Yet most people likely give much more thought to having life insurance than disability coverage.

If you suffered an injury or illness and couldn't work for weeks, months or even years, how would you support yourself and your family?

It's true that some government-provided benefits may be available. Social Security provides disability benefits to qualified individuals under age 65, while Supplemental Security Income pay benefits to disabled persons over age 65. But neither program covers partial disability, and both programs define disability strictly.

Speaking of definitions, policies vary widely in how disability is defined. And benefits apply only if you meet the specific definition present. All policies define disability either according to how an illness or injury affects your ability to do your job or any job (total disability) or according to how it affects your ability to earn income (residual disability). Make sure you understand what will be covered by each policy.

Disability policies typically require that you meet a stated amount of time (frequently referred to as the elimination period) before you're eligible for benefits. Then benefits paid typically range from 50% to 70% of your normal earnings, subject to a monthly maximum and

time period.

Typically the shorter the elimination period and/or the longer the benefit period, the higher premiums you will pay.

There are both short and long-term policies. Short-term benefits cover temporary disabilities that last for a few weeks or months. Long-term insurance covers disabilities that last for an extended period, such as two years, five years or even a lifetime.



If you can't afford both short- and long-term benefits, it's generally preferable to purchase long-term coverage. Think about the big picture when making this decision. Individuals may rely upon cash reserves to help them get through shorter periods of disability. But a longer-term or even total disability would require a much larger cash cushion that's typically not within the average person's easy reach.

Also consider the tax impact. Paying for your group disability premiums with after-tax dollars keeps the benefits from being subject to federal income tax liability. Premiums paid for group disability coverage on a pre-tax basis subjects all potential future benefits received to taxation.

Even if you have disability coverage through your work, you may want to consider purchasing additional protection on an individual basis. Frequently group coverage is inadequate in terms of replacing all lost income, and most likely you can't take the coverage with you should you change jobs. Individual policies can be tailored to meet your specific needs and may even offer more liberal benefits than those offered through group policies.

Here are a few considerations to keep in mind when considering the purchase of disability coverage:

- how does the policy define 'disability'?
- what base and optional features does the policy offer? How long is the elimination period and the benefit period? Are optional benefits, such as a cost-of-living rider that adjusts the benefit levels for inflation, available?
- what does the policy cost? If comparing premiums, make sure that the comparison is for equivalent policies.
- what is the insurer's financial rating? Look for a highly-rated company in terms of financial strength and claims-paying ability. •

Minding Your Rollovers

If you've changed jobs or retired recently, you face an important decision. What should you do with your retirement savings account, such as a 401(k) or 403(b)?

Or suppose you have inherited an IRA from a family member. Do you know about your possible options and potential tax liability?

With either situation, rolling the

monies over to an account in your name probably gives you the most flexibility. But specific procedures must be followed!

Let us help you consider the various possibilities when you face these decisions. We can discuss the specific steps involved, suggest appropriate investments and assist you with the transfer process. •

Why Re-Balance?

Energy-related, precious metals and international investments have performed well recently. Before that, REITS did well. No doubt portfolios with those types of holdings benefited from nice gains.

So what's all the fuss about trimming back to some target portfolio percentage allocations? If those sectors are performing well, why not stay with them for the duration?

Stated simply, it can be dangerous to ride a tired horse.

The markets are in a volatile period just now. Investments generally do not perform as well during the May through October period as during the remaining months. There's uncertainty about the strength of the domestic economy and inflation. Interest rates have been inching upward. And there's a new chief, with an unknown track record, at the Federal Reserve. Global economies are more interdependent these days, and emerging markets remain highly volatile. Plus terrorism and war remain big concerns.

Those few concerns alone are more than enough to prompt volatility.

Following a sound asset allocation strategy can actually help reduce portfolio volatility, thereby preserving gains or reducing losses on the downside. A casual investor need glance only briefly at a table listing the best and worst asset class performers over the past 20 years to realize that there are no discernable patterns. And if such patterns did exist, surely brilliant minds would have already identified the logic and become very wealthy!

No, there are no secrets. Rather, a successful strategy rests on having a diversified portfolio, including exposure to appropriate asset categories based on your individual risk tolerance and time horizon until the money is needed.

Let's think back to that tired horse.

Sometimes arriving late to the party is worse than never arriving at all. As Jonathan Clements recently noted in his *Wall Street Journal* column, an investor can notch impressive one year gains by buying stocks (or mutual funds) that have posted healthy gains over the prior 3 years to 12 months. Price gains of the underlying company prompt more and more investors to chase that momentum by buying the stock. Thus as demand for the stock increases, so does the stock price.

But at some point the bubble bursts and the price begins to decline. That momentum chase with continued price increases rarely lasts longer than 3 years from the time the stock/sector first became attractive.

We saw that with high-flying technology stocks that were so popular in the late '90s. Their stock prices tumbled in the early 2000s.

Emerging market stocks generally held up well during 2001 and 2002 and then posted spectacular returns over the next 3 years. But they came crashing back down in May. Investors who chased the market's hottest performers in this sector likely got burned.

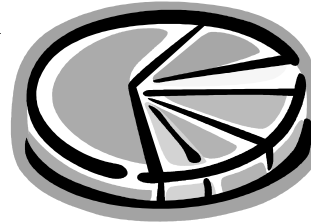
Some asset categories have more inherent risk present than others. Think the smallest-cap companies, commodities, emerging markets and precious metals as examples.

Trimming increased positions in more risky categories is a must for limiting downside potential. Those gains are nice and the added diversification probably helps the portfolio achieve better overall returns.

There's a similar analogy with cook-

ing. A little spice can enhance a dish nicely. But too much spice can also quickly ruin the dish.

So it is with investing. Too much spice, or too many of the more risky investments, among your holdings can quickly lead to very disappointing results overall for your portfolio.



Being disciplined with your buying and selling will typically help you avoid that fate. That's what re-balancing is all about.

Once you set target percentages, or allocations, for various asset categories, or sectors, then tweak your portfolio once or twice a year to bring it back in line with your target percentages. Sell some holdings in areas that now exceed their target allocations — especially the more volatile ones — and use the proceeds to buy additional holdings in areas that have become underweighted — or even park the proceeds temporarily in cash to await new, attractive buying opportunities.

Ideally try to make the major adjustments in your tax-deferred accounts, such as your 401(k) or IRA, to avoid triggering a tax liability.

Re-balancing taxable accounts might involve a more subtle strategy, such as re-directing dividends and capital gains from overweighted sectors to investments in segments that have become underweighted. A second possibility is taking any needed withdrawals from holdings in overweighted sectors. And yet another viable option involves tax loss harvesting, whereby gains in overweighted sectors are offset against any available losses.

In short, think back to your recipe, and keep all of the portions balanced! •

The Annual Check-up

(continued from p. 1)

appropriate, in light of tactical or strategic asset allocations in place. Other times changes may be suggested based on certain life events, such as a change in marital status or the birth of a child or grandchild.

In addition new developments relating to various financial issues may warrant discussion and further review of the client's plan. Recent examples include changes brought about by the tax legislation adopted in 2005, introduction of the ROTH 401(k), the new Medicare Part D coverage or continued escalating costs for health care and long term care during retirement.

Of course an important part of this annual review is measuring the performance of the client's investment portfolio. This performance should typically be measured against several benchmarks, the most important of which is the client's own personal goals. For example, if the planner and client established that a portfolio should grow by 6% per year before taxes, the review should note progress against that benchmark.

It's also important that portfolios be measured against standard market benchmarks, such as the S&P 500, Russell 2000 or the Wilshire 5000. But those measurements serve only as a point of reference. Meeting personal investment goals is far more important than over- or underperforming a market benchmark.

One of the most important documents in the annual review is the client's balance sheet or net worth statement. If achieving all of a client's goals will require a net worth of \$1 million at some point in the future, it is the balance sheet that will reflect progress toward or away from that goal.

The balance sheet is a road map. When planning for an out-of-town trip, most folks refer to a road map both before and during the trip. Progress toward their ultimate destination is noted by each passing town or landmark. The road map provides an easy reference tool so you know if you've moved off track, and, if so, what corrections are needed to get back on track.

So it is likewise with the balance sheet. It measures your progress toward monetary goals in a finite manner. What these numbers show from year-to-year are not as important as what they show after several years when viewed as a big picture.

In summary, annual reviews provide the opportunity to review a client's progress toward reaching long-term goals. It's also the perfect time to note any changes that may have occurred and adjust strategies so the client remains on course. Shorter-term adjustments are easier to make — and usually much more palatable — than having to pursue several major modifications when only a few years remain before the client plans to begin tapping into that nest egg. •

By the Number\$. . .

40 . . .

Percentage the price of crude oil rose in 2005 (Wall Street Journal)

1200 . . .

Number of mutual funds that merged or were liquidated in 2005 (MarketWatch)

15,000 . . .

Number of tax law changes since the 1986 tax act (Associated Press)

8 . . .

Number of times the Federal Reserve raised interest rates in 2005 (Ft. Worth Star Telegram)

39 . . .

Percentage of taxpayers who didn't do anything to minimize their 2005 tax liability (Wall Street Journal online)

33 . . .

Percentage of U.S. companies that offered current workers retiree health benefits in 2005, versus 66% in 1988 (Watson Wyatt)

16 . . .

Percentage of large employers offering health savings account plans in 2006, versus 6% in 2005 (Watson Wyatt)

Painful Payout?

(continued from p. 1)

any payouts made in taxable accounts are subject to current income tax liabilities. Recall that qualified dividends and long term capital gains receive more favorable tax treatment than other types of income.

Having an unexpectedly large amount added to your taxable income may mean your overall tax liability for this year will be higher than you anticipated. However the good news is that plenty of time remains before year-end, during which you can re-assess your tax picture and become pro-active in your planning.

Now more than ever, take advantage of opportunities to weed underperformers from your portfolio, offset gains with any available losses and pursue other advantageous strategies. •