Financial Solutions Advisory Group
Changing the Financial Service Experience

Financial Solutions

Newsletter

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Stronger Than Expected '03 Paves The Way For '04

After three down years in the market, most investors and analysts were expecting modest gains - 2003 returns proved to be anything but. The DOW, S&P and NASDAQ were all up 25%, 26% and 50%, respectively. Mid Caps and Small Caps were up 34% and 45%, respectively.

Economy & Interest Rates
GDP grew at an 8.2% rate in the third quarter but is expected to slow in 2004. Most analysts expect GDP growth between 3 - 4% for 2004 based on strong manufacturing activity but a continued weak labor market. Consumer spending, which had been fueled by tax rebates and mortgage refinancing, is expected to slow after 2003 tax refunds are received.

The Fed is expected to remain on the sidelines at least the first half of 2004. Rates are not expected to increase until inflationary fears pickup. The CPI is currently 1.8%, down from 2.0% while the core rate dropped as well, from 1.3% to 1.1% - the slowest pace since 1966.

Stock Market
We remain positive on the equity markets for 2004 given the historically low interest rate environment, consistent GDP growth, increased business spending and corporate earnings.

Of course, some risks exist, including rising interest rates, the November elections (if the Republicans were to loose control), job growth and the possibility of future terrorist attacks.

<u>2003 In Review</u>

DOW	*25.32%*
S&P 500	*26.38%*
NASDAQ	*50.01%*
Russell 2000	*45.37%*
Mid Cap 400	*34.02%*
MSCI EAFE	*35.28%*
10 Year Treasury	*1.38%*
Lehman US Agg. Ind.	*4.11%*
ML 7-12 Yr G.O.	*5.39%*

Beware the AMT

The IRS has special rules that determine the minimum amount of tax someone with your level of income should have to pay. If, using the IRS' regular tax rules, your tax liability falls below this minimum amount, you'll have to pay the difference. That difference is called the AMT (alternative minimum tax), and

the special rules that determine the minimum amount of tax due are known as the alternative minimum tax rules.

You, too, may have to pay
The AMT was originally intended to prevent the very rich from using tax "loopholes" to get away tax free. But now, the AMT snags

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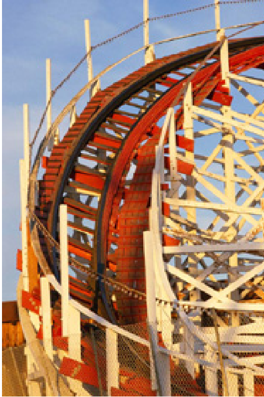

Five Hints for Handling Market Volatility

Though there's no foolproof way to handle the ups and downs of the stock market, the following common sense tips can help.

Diversify your portfolio
Spreading your assets across a variety of investments such as stocks, bonds, and cash equivalents, may help offset short-term declines over time. Different investments typically react differently to market conditions, so a gain in one may balance out a loss in another.

Focus on the big picture
If you're years away from a long-term goal such as retirement or sending your child to college, don't overestimate the effect of short-term price fluctuations on your portfolio. Although only you can decide how much risk you're willing to accept, you may be able to reduce the effect of short-term fluctuations by holding investments over the long term, though there are no guarantees.

Be realistic about market ups and downs
A market recovery is a good thing, but as many investors have learned the hard way, becoming overly optimistic during the good times can be as detrimental as worrying too much during the bad times. The right approach in all markets is to be realistic. Stick with your plan, and strike a comfortable balance between risk and return.

Review your portfolio
Your needs change over time, so review your portfolio at least once a year, or more frequently if the market is particularly volatile. You may need to rebalance your portfolio occasionally to realign it with your investment goals and tolerance for risk.

Consider a professional money manager
Not everyone has the knowledge or the tools to manage their money themselves. A professional money manager offers the expertise you need to stay on track, while at the same time helping you avoid the pitfalls that could keep you from reaching your goals.

"A professional money manager offers you the expertise you need to stay on track..."

Beware the AMT

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more and more middle income taxpayers each year. Why is this happening? Mainly because the AMT doesn't keep up with inflation like the regular tax does. And matters are expected to get worse in coming years as the regular tax rates are lowered.

How is the AMT Calculated?
Calculating the AMT can be complicated and confusing, especially if you file a paper return. You must first calculate how your regular tax is using Form 1040. Then, you must make a second calculation for the AMT using Form 6251. Basically, for this calculation, you start with your income from Form 1040 after adjustments and deductions but before personal exemptions and credits. Then, you add back in certain tax benefits you were able to take under the regular tax rules, such as the standard deduction or, if you itemized, certain itemized deductions (these add backs are called "preferences" and "adjustments"). The results is your AMTI (alternative minimum taxable income). You can then reduce your AMTI by an exemption amount:

- $58,000 if married filing jointly or qualifying widow(er)
- $40,250 if single or head of household
- $29,000 if married filing separately

Note: the exemption amount phases out when your AMTI exceeds a certain threshold.

The first $175,000 ($87,500 if married filing separately) of the remaining AMTI is taxed at a flat rate of 26%, with any AMTI above this amount taxed at a rate of 28%.

If the tax calculated under the AMT rules exceeds your regular tax liability, you must pay the difference in addition to the regular tax. If your regular tax exceeds the AMT, you do not owe the AMT. Thanks to the advent of e-file or other tax programs that do the math for you, calculating the AMT no longer needs to be so onerous.

"Calculating the AMT can be complicated and confusing, especially if you file a paper return."

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Go... And Take Your 401(k) Funds With You

When an employee leaves a job and his or her vested 401(k) balance is $5,000 or less, the 401(k) plan can require that the employee receive a single lump-sum "cash-out" of his or her entire benefit. This cash-out is often referred to as an "involuntary cash-out" because the employee's consent is not required. Unless the employee transfers the funds to an IRA or another employer's retirement plan via a qualifying rollover, he or she will have to pay federal income tax on the distributed funds, and possibly an additional 10% premature distribution tax.

401(k) Options When You Change Jobs

You're leaving your current employer because you've got a new job, but it may be some time before your first paycheck from your new employer. Or perhaps you've become a victim of downsizing, and are just now beginning a job search. In either case, you might be facing a short-term cash crunch. When you review the options available to you for your existing 401(k) plan, "cashing out" your vested 401(k) balance might seem like the perfect solution.

Don't do it. At least, don't do it without really understanding your options. Taking a lump-sum distribution is a bad choice for most people. Why? First, you'll have to pay taxes on the funds you receive, and those funds will no longer grow tax deferred. Second, if you're under age 59 ½ (under age 55 in some circumstances) you'll have to pay an additional 10% premature distribution tax. Most importantly, though, you'll be dealing your retirement savings a severe blow.

So what should you do? You generally have the following options:

- Do nothing—keep your funds in your old employer's 401(k) plan if you like the investment options available in the plan (you might not have this option if your vested balance is $5,000 or less).
- Transfer the funds directly to your new employer's 401(k) if the plan allows you to do so.
- Transfer the funds directly (a "direct rollover") to a traditional IRA that you already have or that you establish for this purpose. This option offers you the widest array of investment options and professional money management.

In all three cases, your funds will continue to grow tax deferred. When it's time to retire, you'll thank yourself.

"Direct Rollover IRAs offer the widest array of investment options and professional money management."

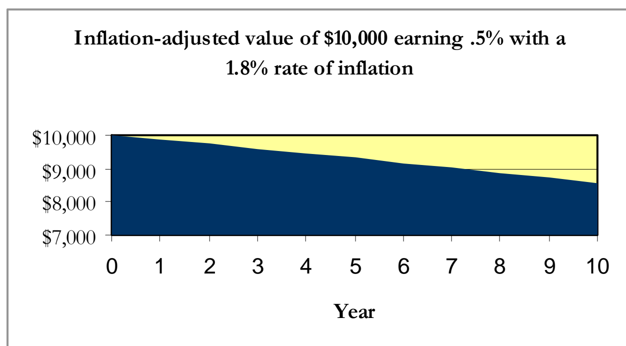
When a Penny Saved is Less than a Penny Earned

If you're putting money in a money market account and think you're making financial headway, think again. Inflation is eroding your money's purchasing power.

With the current inflation rate of 1.8% and average money market yields at .5% (bankrate.com, 12/30/2003), you could actually be losing 1.3% of purchasing power each year.

If these deposits are in a taxable account, you're probably faring even worse.

Consult your investment advisor to explore alternatives to the historically low money market yields.



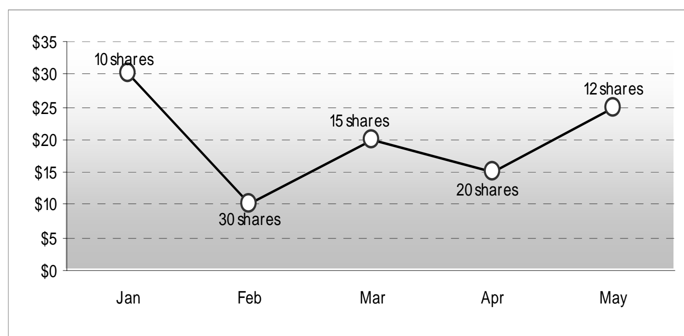
"Consult your investment advisor to explore alternatives to the historically low money market yields."

Dollar Cost Averaging

If you want to invest regularly, regardless of market conditions, consider using an investment strategy called dollar cost averaging.

With dollar cost averaging, you invest the same dollar amount at regular intervals over time. By consistently following this strategy, you may be able to reduce the impact of market fluctuations on your investment portfolio.*

For example, let's say that you decide to invest $300 each month towards your child's college education. As the following illustration shows, you automatically buy more shares when prices are low and fewer shares when prices are high.



** Dollar cost averaging does not guarantee a profit or protect against a loss in a declining market. Investors should consider their ability to continue investing regularly through all types of markets.*

This hypothetical example is for illustrative purposes only and does not represent the performance of any particular investment. Actual results will vary.

A dollar cost averaging technique will also help take the emotion out of your decision making. All too often investors want to buy more shares while the market is rising and less shares when the market is declining. Dollar cost averaging will help you avoid making this mistake.

Beware the AMT

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What triggers the AMT?
The AMT can be triggered if you have items that are disallowed by the AMT rules (those "preferences" and "adjustments"). You may be at risk if you have one or more of the following:

- A large number of personal and dependency exemptions
- High medical and dental expenses
- High state, local, personal property, and real estate taxes
- Home equity loan interest (where loan is not used to buy, build, or improve your home)
- High work-related and other miscellaneous deductions
- Investment interest expenses
- Interest from private-activity bonds that would normally be tax exempt
- Passive activity losses
- Incentive stock options that have been exercised
- Gain or loss from the sale of depreciated property
- Business expenses and losses

What does this mean for you?
Since the number of taxpayers affected by the AMT continues to increase each year, you may be more vulnerable than you think.

The first thing you should do is to pay attention. Run the numbers every year, even if the AMT will not apply, to see how close you are to paying the AMT. If you're getting close, it may be time to start incorporating AMT tax planning with your traditional tax planning.

Planning for the AMT can be tricky because AMT tax planning strategies can sometimes be contrary to regular tax planning strategies. See a tax professional, and review your tax planning from time to time throughout the year.

Is your investment advisor meeting your needs?

Financial Solutions is an independent, Registered Investment Advisor with the Securities and Exchange Commission. We offer financial planning, investment management and retirement plan services.

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