

WEALTH MANAGEMENT JOURNAL

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MISSION STATEMENT

The mission of the *La Jolla Institute for Wealth Management* is much more than money management! Wealth Management deals with a PHILOSOPHY for investing--developing a process rather than selling a product. Wealth management builds decision-making skills as a foundation for a financial business plan for you and your family. Our client relationship is built on a partnership for success that recognizes the need for a thorough understanding of your situation. Our primary focus is:

- OBJECTIVE & COMPETENT INVESTMENT COUNSEL
- Estate & Income Tax Planning
- Inter-Generational Succession Wealth Management Trust™
- Capital Preservation & Asset Protection
- Retirement Planning & Distribution Analysis

Our goal is to be the leading provider of wealth management services to families, professionals, small to medium businesses, retirement plans and trusts.

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When The Going Gets Tough — Don't Lose Your Balance!!

You're Okay, I'm Okay!!

We're okay, if we remember, we are investors in balanced, diversified portfolios, invested for the long-term. Today's tough markets favor those who accept this risk tolerance and can hang-in-there over the turbulent and volatile months ahead. *Figure 1* notes that during August of this year, the Dow Jones Industrial Average (DJIA) had finished with moves of more than 100 points in 11 of 16 trading days. This

“perfect financial storm” is prompting global investors to re-consider risk in their portfolios; some going defensive (cash and bonds), others just selling (a buying opportunity for us)!! Remember well, it is time in the market that counts rather than timing the market!

Fear and Greed

Both emotions are basic, but compelling human traits. In tandem, they drive the

(See *Balance Page 3*)

A Long Bull Run (Figure 1)

The DJIA is up 82% since the bull market began on 10/9/02. Whether the bull will make it to its fifth birthday is anybody's guess after weeks of roller-coaster trading sessions.



Source: WSJ Market Data Group

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Don't Overlook Nondeductible IRAs

The chances are good that if you participate in an employer-sponsored retirement plan, you may not qualify to make *tax deductible* contributions to an individual retirement account (IRA). Although you can always make a contribution to a *nondeductible* IRA (assuming that you or your spouse have earned income at least equal to the contribution), most people don't bother doing this. Such a contribution doesn't yield a tax deduction and although the earnings inside the account build up tax deferred, they're fully taxable as ordinary income when they're distributed.

Instead, people who want to maximize their retirement savings beyond what they're saving at work typically use a Roth IRA account if they qualify (the Roth IRA doesn't provide an upfront deduction, either, but it does allow earnings to build up tax-free, rather than tax-deferred) or invest in a taxable account such as a tax-efficient mutual fund that will yield mostly lightly taxed capital gain income.

Based on a recent law change, the use of a non-deductible IRA now looks more appealing for taxpayers who can't qualify to make a Roth IRA contribution (because their income is too high). The new provision allows taxpayers, beginning in 2010, to convert traditional IRAs (such as nondeductible IRA) to a Roth IRA regardless of the taxpayer's

income level. Currently only taxpayers with modified adjusted gross income of no more than \$100,000 can convert a traditional IRA to a Roth IRA. At the time of the conversion, ordinary income tax is due on the income portion of the IRA, but future earnings accrue tax-free. In addition, for conversions in 2010, the new law allows the resulting tax to be paid over two years – 2011 and 2012.

"... if you're not yet age 70 ½ and want to maximize the funds that can go in a Roth IRA in 2010 or later, you should be funding nondeductible IRAs now "

Why are we bringing this to your attention more than two years before 2010? Because, if you're not yet age 70 ½ and want to maximize the

funds that can go in a Roth IRA in 2010 or later, you should be funding nondeductible IRAs now – up to the lesser of your earned income or \$4,000 (or \$5,000, if you are age 50 or older by the end of the year for which you're making the contribution). It's not too late to fund for 2007 provided you know you'll have at least \$4,000 (or \$5,000) of earned income for the year.

Please feel free to call us if you'd like to know more about this opportunity for maximizing the tax efficiency of your retirement savings.

"As a novelist, I tell stories, and people give me money. Then financial planners tell me stories, and I give them money."

~Martin Cruz Smith

Balance

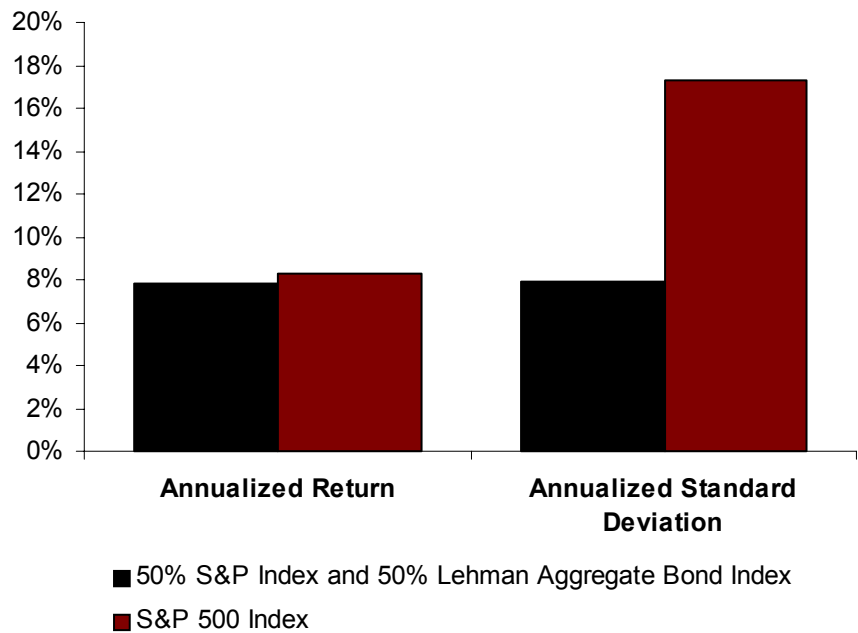
(From Page 1)

investment decision making process, especially when they relate to our money and wealth. *Figure 2* drives home the point of this article: Investors who stayed the course in U.S. stocks through the bull market of the late 90s and the down market in early 2000-2003 would have had over 120% growth in wealth! Compare this return to the “in and out” bunch who missed the five-best-performing months for U.S. stocks – their gain was only as much as Treasury Bills.

Query

So we know fear overestimates risk and greed underestimates risk. Given this intuitive sense and knowing market timing doesn't work on a consistent basis, how do we manage risk in your portfolio?

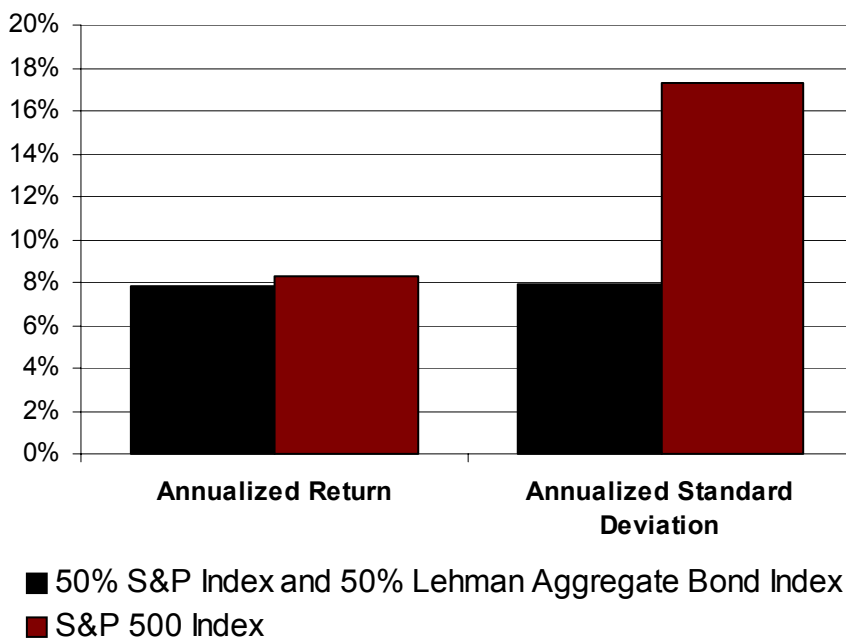
Hypothetical Growth of \$10,000 1/97 - 12/06 (Figure 2)



Source: BGI, Lehman Brothers, S&P.

Performance of stocks captured by the S&P 500. Performance of 3-month T-bills captured by the Lehman Brothers U.S. Treasury 3-month Bellwether Index.

The S&P 500 Index vs. a 50/50 Combination Portfolio (Figure 3)



Source: Lehman Brothers and Bloomberg

You and I have a “risk budget” – a new scholar term – a limit on the amount of loss we’ll accept in our investment portfolio. Perhaps a percentage of it could be a dollar amount, too. In any event, our “investment process” stresses three tenets: an Investment Policy Statement (IPS) and Asset Allocation, investment selection, and rebalancing. Of these three cornerstones, I believe Asset Allocation is the most critical element; the right mix of assets is the blueprint for investment strategy and balancing the portfolio’s total return versus the portfolio’s risk. Diversification across a variety of asset classes, geographies, sectors and

(See *Balance* Page 6)

the DUKE & DATE

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'Tis The Season

Here is the year-end checklist for 2007 to reduce taxes or just improve your financial foundation.

the required minimum distribution, avoiding income tax on the withdrawal.

- Defer new mutual fund purchases until after funds make year-end capital gain distributions.
- Stock market volatility this year may have upset your asset allocation mix. Good time to harvest gains/losses, too.
- Make intra-family gifts up to \$12,000 per person gift-tax free. Additional money for tuition and medical expenses in any amount are tax-free.
- Charitable IRA distributions only in 2007. Over age 70 IRA holders can give up to \$100,000 to charity; no charitable deduction is available, but the distribution counts towards
- Review beneficiary designations on retirement accounts and life insurance. Make sure they fit with your overall estate plan.
- If you are subject to AMT, add AMT-free muni bonds to your portfolio, or more taxable income.
- Make IRA, 401k contributions before-year-end. \$15,500 for 401(k)s and \$4,000 for IRAs with an extra kicker to age 50+. \$5,000 for 401(k)s and \$1,000 for IRAs.
- Be well and enjoy this Holiday Season with family and friends.



Want to compare your deductions with those of other filers?

Check the averages for taxpayers of various income levels who claimed the write-offs. We used IRS data from tax returns for 2005.

| Adjusted Gross Income | Taxable Income | Interest Expense | State and Local Taxes | Charity | Medical Expenses Deducted | Total Itemized Deductions |
|-----------------------|----------------|------------------|-----------------------|---------|---------------------------|---------------------------|
| Under \$15,000 | \$3,048 | \$7,393 | \$646 | \$1,403 | \$7,529 | \$13,661 |
| \$15,000-30,000 | 10,007 | 7,293 | 983 | 1,916 | 6,515 | 13,999 |
| \$30,000-50,000 | 22,803 | 7,582 | 1,655 | 2,158 | 5,625 | 14,874 |
| \$50,000-100,000 | 47,243 | 8,946 | 3,125 | 2,703 | 6,144 | 18,769 |
| \$100,000-200,000 | 98,092 | 11,927 | 6,234 | 4,057 | 9,727 | 27,423 |
| \$200,000 & above | 518,585 | 21,166 | 30,879 | 20,434 | 30,952 | 70,533 |

“Will You Still Need Me, Will You Still Love Me When I’m 95? But Will We Have Enough Money?”

Brother, this “Do we have enough” theme is everywhere. Every day I read of another study on longevity and the fear of investors running out of money. Yet many serious students of this longevity and spending policy consider this issue the most critical facing current retirees and Baby Boomers. To my mind, the risk of running out of money can be calculated and mitigated by implementing a cash flow analysis, shifting the risk of living too long to an insurance company, and managing the allocation and timing of income sources.

Its Different Now

“In the old days” – yes, you heard it here, too – retirement planning was a snap! You had Social Security, a pension, personal savings (usually CD’s, bank savings, T-Bills) and maybe a few stocks or a mutual fund. Collect the income, live 10-15 years, and it was a good life. Well those days are over – new dynamics are reshaping retirement systems; healthcare costs are increasing

“What else is there but value investing, really? Tipster investing? Dream investing? I never understood the alternative.”

~Warrent Buffet,
SmartMoney, August 2007

at 5-7% per year; and retiree spending is increasing at an alarming rate. Faced with more government spending, higher taxes, and real inflation (check-out counters at Vons don’t lie), no wonder Mexico, Costa Rica and Belize are in the Top 10 Favorite Retirement Places.

“With our projected long-life expectancy, its when, not if, we are going to need to spend our resources on special care.”

A Successful Retirement Strategy

In our planning, I identified the two biggest risks we will

face. Living more than 30 years in retirement – a couple aged 65 and about to retire, face the probability of 50% that one will live to age 91 and a 25% chance that at least one of us will live to 96! Part of this risk analysis is the fact that statistically women live longer than men, and our income resources will have to do more.

The second hurdle is health care costs. A study by MetLife cites the average cost of a private nursing home room is about \$75,000 per year. One of our clients spent over \$100,000 in 2006 for health care over and above Medicare, a Medi-Gap policy and an AARP Long-Term Care Policy (very little coverage). At one point, her expenses were running \$15,000 per month for

nursing and private 24-hour care. With our projected long-life expectancy, its when, not if, we are going to spend our resources on special care. Medicare is on shakier ground than Social Security, and my guess is the government won’t be able to finance nursing home care for all the ill-prepared Baby Boomers.

Given this information, what have I done to protect us against the risks?

Best Laid Plans:

1. Continue to work/teach as long as I enjoy this wonderful business;
2. Delay taking Social Security payments;
3. Purchase annuities to cover fixed expenses; it’s the only guarantee I have other than death and taxes; discretionary (lifestyle) expenses are covered in my growth portfolios; we don’t expect to reduce spending in our retirement in the “Younger Phase” – where we are more active – the older years will be less active, but health-care costs will certainly increase;
4. We each have a long-term care insurance (LTCI) policy we purchased 8 years ago. I feel this is the right decision for us. LTCI is

(See *Best Laid Plans* Page 7)

Balance

(From Page 3)

manager styles – the negative impact of a single asset class (e.g. – Real Estate) can be moderated.

Put A Damper On It!

If this “its up, its down, its up,” pattern is becoming the norm, then our risk management must adapt! How? By adding or increasing the percentage of highly rated fixed income holdings to our portfolios. As a recent Lehman Brothers/Bloomberg study exhorts, highly rated fixed income holdings not only reduce volatility, but also give a higher risk-adjusted rate of return over time. We acknowledge that fixed income assets show lower returns than stocks, but have much lower volatility. The result is a lower risk-adjusted return.

Figure 3 illustrates the S&P 500 Index return over the past 10 years (ending 12/31/06) versus the return of a 50/50 mix of the S&P 500 Index and the Lehman Total Bond Index. The S&P had a 8.42% annualized return, the 50/50 stock/bond combo returned 7.81% Query – was the 0.62% extra return for the S&P worth the substantial difference in standard deviation (risk) – 17.27% S&P; 8.07% 50/50 portfolio? Good stuff for tough times!

Get Real

A key component to our balanced strategy for tough times supports the

addition or increase of municipal securities in “taxable” accounts. Thornberg Investment Management just released their 14th year study: “A study of Real Returns.” No surprise that over the past 20 years, common stocks and municipal bonds provided the best “Real Real Returns” (RRR) for taxable accounts. Regardless of this historical data, we feel RRRs will be compressed due to higher federal/state income taxes, inflation and lower interest rates. (Hear the “R” word)

Stocks have benefited from the lower capital gains rate (15%), but don’t “Real Return” is the nominal return less inflation, taxes and expenses count on that continuing in 2009. The new administration and a friendly Congress will most likely raise both capital gains and income taxes. Increase in Fed spending for “pork” and entitlements will push inflation higher and reduce returns.

Going forward we will make specific suggestions in your accounts along these guidelines:

- I. Taxable Accounts
 - A. 50% Stock Index/ETF Funds (half in International Securities)
 - B. 50% Tax-Exempt Securities
- II. Tax-Exempt Accounts (IRA, 401k, Pension Plans)
 - A. 50% Stock:
25% International

25% Total U.S. Index

- B. 50% Fixed-Income:
 - 10% High Yield,
 - 5% REITS
 - 5% International Income
 - 30% Intermediate Bond

A Good Defensive

A good defense is a good offense, as the old adage goes. Perhaps a better game plan is to manage our expectations better. We don’t know how it will turn out, but with a new administration, lower corporate earnings, increased taxes and inflation at home, our allocation of 25% to International exposure, more bonds and cash reflects the uncertainty around us. We’ll stay balanced, keep expenses low with index funds, and trust the capital markets to meet our managed expectations.

Buckle up and remember time is on the side of long-term investors!!

"Despite its economic might, the U.S. only accounts for approximately 45% of the world's total stock market value. So, if you've got 80% of your stock holdings invested domestically, you're making an enormous bet in favor of the U.S. market."

~Christopher Davis,

THE BACK PAGE

The La Jolla Institute for Wealth Management

The La Jolla Institute for Wealth Management is an independent advisory firm that secures investment, legal and insurance services from leading third-party providers. We offer objective advice to clients on a fee-based retainer. The Institute provides the following wealth management services:

Life Insurance

The Institute reviews and analyzes insurance needs, including existing and proposed life and disability contracts. Clients receive substantial savings plus objectivity in placing the proper amount and type of insurance.

Estate Planning

The Institute performs tax and distribution analyses, develops and assists in implementing wills, trusts, intra-family and elder care planning, and family business succession.

Severance Benefit Planning

The Institute develops and installs severance benefit plans for corporate sponsors. We also represent severed employees in negotiations with employers to assure an equitable settlement. Our team of legal, actuarial and tax professionals provide knowledge and experience.

Investment Management

The Institute develops and implements your written investment plan, using no-load mutual funds, stocks and bonds. The Institute closely monitors the investment portfolio and provides you with scheduled status reports.

Retirement Planning

The Institute performs plan design, investment funding and distribution analysis of individual and corporate plans.

401(k) Investment Advisory Services

The Institute selects investment options, tracks and reports investment performance, and presents employee education workshops on the basics of investments and retirement planning. We assist in audits of 401(k) plans and offer both bundled and unbundled plans.

~ Check in with Duke ~

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Best Laid Plans

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not for everyone, but the peace of mind is part of the premium payment. We haven't had a premium increase yet (knock on

wood), but I just saw that Genworth Financial, one of the largest LTCI companies has said it will raise premiums for existing policyholders in all 50 states. Increases range from 8-12% on policies sold before 1997. My sense is that other insurers will follow suit.

5. Set-up a cash pool that will grow to cover 3-5 years of distributions at retirement. This should offset any long stock market downturn during my initial distribution phase.

Well that's all folks! For now, I expect there will be many new options and products coming from investment and insurance companies to meet the Baby Boomer challenge of not outliving lifestyle or savings!

"A gentleman is a man who can play the accordion but doesn't."

~Anonymous

"I like to play the saxophone because you don't inhale."

~Bill Clinton

2007 Seasons Greetings

by Judith Johnson

We've come to the end of the year again-
With a teeter-totter market – Oh boy! Amen!
But the Institute's philosophy is a positive one.
We look to the future, carefully done.

We work to balance your assets together,
So you can feel good in not so good weather.
We help with decisions for future occasions,
So you can cope well with all machinations.

And now Duke dons his Santa hat-
So he can be sure to check this and check that!
Wishes, gifts, tax dollars at work-
He knows it all, with a nod and a jerk.

We think our clients are the very best!
We want you to know we work without rest
To better your lives the best way we can.
So your families live better and live with élan.

And to you all, heartfelt wishes we send-
For Holiday cheer with family and friends.
Peace and goodness, a bright shining light.
We hope this New Year will turn out just right!



Duke
Canace *Judith* *Michelle*

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