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# WEALTH MANAGEMENT ADVISOR

TO STAY FINANCIALLY INDEPENDENT, PLAN AHEAD

THE BEST GIFT YOU'LL NEVER RECEIVE
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CASTING A SAFETY NET
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MEASURE FUND PERFORMANCE BY TOTAL RETURN, NOT NAV


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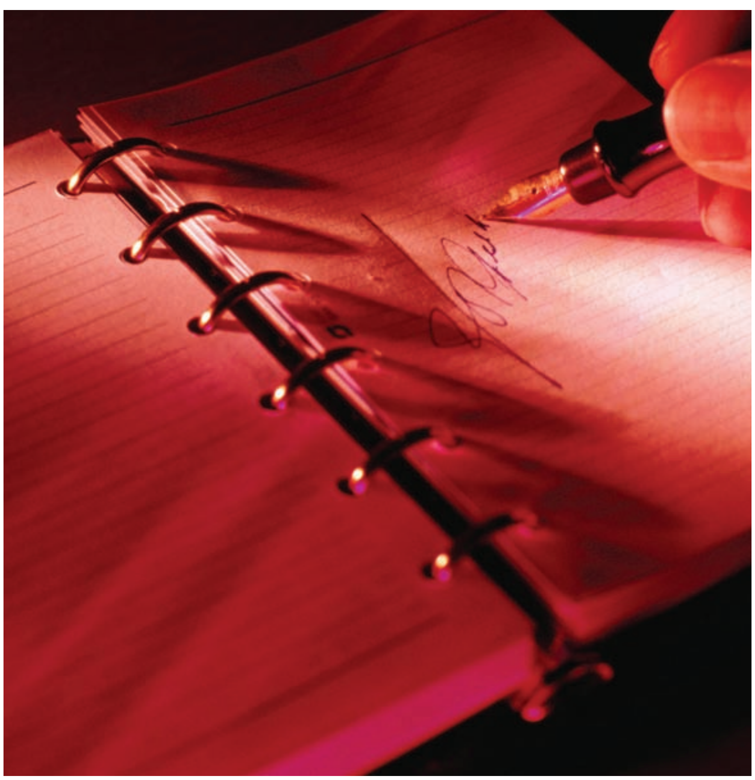
# To stay financially independent, plan ahead

You've worked hard to achieve a certain level of financial independence. But when you're caught up in earning and managing your wealth, it's easy to overlook some of the variables that can undermine what you've been working to achieve. From developing comprehensive financial and estate plans to making sure you have the appropriate insurance coverage, taking a few small steps today can mean greater peace of mind for you and your family.

## Develop your financial plan

A key to maintaining long-term financial independence is to create an individualized financial plan. Because no two people have the same needs, your plan will be as unique as you, reflecting age, health status, tolerance for risk and how you plan to use your assets in the future — to name just a few variables.



If you're relatively close to retirement, for example, you might want a more conservative asset mix, which can help protect your portfolio when you don't have time to wait out a sudden market drop. By contrast, if you're several decades away from retirement, you'll more likely benefit from owning an equity-heavy portfolio, which can provide the growth you'll need to build wealth and keep ahead of inflation.

Even if you're retired, you'll probably want to maintain at least a portion of your wealth in stocks or other higher-growth assets. Today's healthier, more active lifestyles mean that life expectancies are longer than ever before.

## How much do you need?

Another important component of maintaining your long-term financial independence is to develop a suitable income withdrawal strategy. If you withdraw too much early in retirement, you could find yourself having to cut back later on or having insufficient assets to leave a financial legacy to your family. Withdraw too little, and you could miss opportunities to enjoy your retirement to the fullest.

Like your financial plan, your withdrawal strategy will be highly personal. That's why you need to consider rules of thumb — such as sticking to an annual withdrawal rate of 4% or less — as useful guidelines but not immutable laws. Such one-size-fits-all solutions generally aren't appropriate for complex financial situations.

The amount of income you'll need in retirement obviously will depend on your priorities. If you're planning to travel extensively, your needs will be very different than if your primary goal is to stay close to home to spend more time with your family. Your overall wealth management plan should reflect these priorities.

If you own assets in a variety of tax-free (such as a Roth IRA), tax-deferred (such as a 401(k) plan or traditional IRA) and taxable savings vehicles, there can be some significant tax implications to how you withdraw your assets. Conventional wisdom says that taxable assets should be withdrawn first, leaving your tax-advantaged holdings more time to grow.

This approach may work in some situations, but it's not necessarily the correct approach for everyone. Once again, your advisor can be a big help in developing a tax-friendly withdrawal plan.

## What about tomorrow?

If your plans for your wealth include having some to pass along to the next generation, it's important to prepare for the unexpected. Consider the following:

**Sufficient insurance.** If you have dependents, make sure you have sufficient life insurance protection to maintain your family's lifestyle if you or your spouse were to die unexpectedly. Also consider long-term care insurance, which can protect you from the high cost of nursing home or other long-term care down the road.

A key to maintaining long-term financial independence is to create an individualized financial plan.

**A will.** A will can ensure that your assets are efficiently distributed according to your wishes, but a surprising number of people overlook this simple step. If you have a will but haven't updated it in a while, make sure it reflects any recent changes to your family or financial status.

### A moving target?

Although the estate tax currently is scheduled for elimination in 2010, it's also due to return in 2011, unless Congress acts to make the repeal permanent — far from certain in today's political climate. Currently, the federal estate tax exemption is $2 million and is scheduled to increase to $3.5 million in 2009. But it will revert to $1 million in 2011 without congressional action.

No one knows for certain what will happen to the estate tax. That makes it particularly important to develop a flexible estate plan and to work closely with your financial advisor to keep it current.

**An estate plan.** Although the estate tax is slated to disappear in 2010, its future is in flux. (See "A moving target?" above.) Work regularly with your financial advisor to keep your estate plan adaptable in a changing political environment.

**A gifting strategy.** Making annual gifts can help you accomplish two important goals: remove assets from your estate, and pass along assets to loved ones. Current law allows annual tax-free gifts of $12,000 per recipient per year ($24,000 for married couples). Making annual gifts can be a surprisingly powerful way to reduce your estate. For example, if you and your spouse made the maximum gifts to each of your three children over a 10-year period, you'd be able to remove $720,000 from your estate tax-free, without even considering appreciation on the amounts you give away.

## Revisit your plans regularly

The more wealth you have, the more you have to lose — and the more important it is for you to make sure you've done what's necessary to preserve your financial independence for yourself and your family.

Wealth planning is an ongoing process. Be sure to meet regularly with your financial, tax and legal advisors to keep your plans up to date and obtain the greatest possible benefit from your planning. ■

# The best gift you'll never receive

## Gifting highly appreciated securities to charity

If you've been considering making a sizable donation to your favorite charity, don't. Don't give cash, that is. Because of the tax benefits, gifting highly appreciated securities — such as publicly traded stock, mutual fund shares and closely held stock — may be a more tax-efficient way to make gifts to a charitable organization.

### It just makes sense

If you sell securities that have increased in value since you purchased them, you'll have to pay income tax on the capital gain — even if you then donate the proceeds to charity. But if you donate the actual shares to charity, the charitable organization can sell them, and neither you nor the charity will owe capital gains tax. This results in tax savings for you or a larger gift for the charity.

In addition, you can deduct the securities' full fair market value on the day you make the transfer, so long as you've held the shares for more than one year. If the value of the contributed securities exceeds 30% of your adjusted gross income (AGI), you can't deduct the excess but you can carry it forward for use during the next five years.

### You do the math

Say you decide to donate $5,000 to your favorite charity. Let's compare selling stock and using the proceeds for a donation to donating the stock itself.

If you sell stock that you purchased years ago for $1,000, you'll have to pay a federal capital gains tax of about $600, based on a gain of $4,000 taxed at 15%. The after-tax value of the stock in this case is only $4,400. If you then donate the remaining cash and receive a 35% tax deduction, you save $1,540 in taxes. Your net cost of giving away your $5,000 worth of securities is $3,460, and the charity receives only $4,400.

If you don't sell the appreciated stock, but instead donate it to a qualified charitable organization, there will be no capital gains tax. And because the charitable deduction will reduce your federal income tax by $1,750 (assuming a 35% tax bracket), the after-tax cost of the gift will be $3,250. Your net after-tax cost is less, and the charitable organization ends up with the entire $5,000.

If you don't want to immediately dispose of any of your stock, you can still benefit from this strategy. For example, donate your appreciated stock to charity for the tax benefit. Then use cash to buy back the same stock. When you later sell those shares, your capital gains tax liability will be reduced because of the higher cost basis.

### Give to receive the greatest tax savings

It's important to select the best asset to fund your charitable giving. Typically, it's best to donate a security that would be subject to the highest rate and dollar amount of capital gains tax, if you were to sell it.

For example, you're thinking about giving $20,000 to your favorite charity. Moreover, you're considering gifting one of two different stocks (each currently valued at $20,000) that you purchased 10 years ago: Stock A, acquired for $5,000, and Stock B, acquired for $10,000.

Assuming you're in the 35% income tax bracket, both stocks would be subject to a capital gains tax rate of 15% if you were to sell them. Because Stock A has experienced the greatest gain, more tax would be owed on it than on Stock B. In this case, choosing to donate Stock A would provide you with the greatest tax savings.

### Size up your options

Gifting appreciated securities to charitable organizations can garner significant tax benefits. But consider your entire financial picture, as well as your estate planning goals, before deciding if this approach is right for you. ■

### What you should not (and cannot) donate to charity

A general rule is that you shouldn't gift directly to a charity any securities that have declined in value since you purchased them. Transferring ownership of these depreciated securities — rather than selling them yourself — will forfeit the benefit of claiming a capital loss against your federal income tax. In these circumstances, it's usually better to sell the security yourself and then use the proceeds to make your charitable gift.

U.S. savings bonds also aren't considered suitable for outright charitable gifts. The U.S. Treasury restricts the lifetime conveyance of U.S. savings bonds (Series E, H, EE and HH).

You may give savings bonds only by cashing them in and donating the proceeds, or having the bonds reissued to the trustee of a revocable living trust in which the grantor is the income beneficiary and the charitable organization is the remainder beneficiary following the grantor's death. The Treasury also prohibits a donor from naming a charitable organization as a bond's co-owner or death beneficiary. Generally, the only way to donate U.S. savings bonds is through bequests.

# Casting a safety net

## A buy-sell agreement can protect your business

If you're an owner of a closely held company, you have to consider the possibility a co-owner will leave the company because of retirement, death or incapacitation. If this becomes reality, what happens to the withdrawing shareholder's business interest? Will you and the other remaining owners be able to purchase it? Will you face interference from the withdrawing owner's family?

A buy-sell agreement can help answer these questions.

### Set parameters

A buy-sell agreement is a contract among business owners that sets parameters for the transfer of business interests. It determines the value of the business or defines the valuation method to use, and outlines when and to whom the interests can be sold.

A buy-sell agreement can:

- Preserve or transition the management and control of your company,
- Offset potential conflicts among remaining owners and the withdrawing owner's family members,
- Create a market for the withdrawing owner's business interest, and
- Establish a succession plan to transfer the business from one generation to the next.

Funding your buy-sell agreement ensures that the money will be readily available to cover the terms of the agreement and the purchase.

Funding options include sinking funds, loans, savings plans, installment purchases and life insurance. Funding your agreement with life insurance is a popular method because it can help:

- Ensure that beneficiaries receive the agreed-upon price for the business shares in a timely manner,
- Ensure that buyouts won't put a strain on your company's cash flow or force you to sell off assets to pay the bill, and
- Preserve wealth and liquidity for the withdrawing owner or the deceased owner's estate.

## Two types of buy-sells

Businesses typically choose between two types of buy-sell agreements:

1. **Cross-purchase agreement.** This agreement requires the withdrawing owner to sell his or her interest to the remaining owners. In the case of a death, the insurance proceeds will not be taxable, and a cross-purchase agreement provides the surviving owners with a tax basis equal to the purchase price of the shares.

   Be aware, however, that a cross-purchase agreement can be difficult to administer if there are numerous shareholders. Because each shareholder must own an insurance policy on each other shareholder's life, the number of policies can quickly become unwieldy. For example, if your business has three shareholders, six policies are required, but with six shareholders you need 30 policies. A separate partnership or LLC can be used to own a policy on each owner.

   Additionally, age or insurability can create a disparity in premiums. Younger or healthier owners may incur higher premiums to cover older or less-healthy owners.

2. **Redemption agreement.** This agreement type requires that a withdrawing owner give the business entity first right of refusal if he or she would like to sell the interest to a nonowner. If the agreement is funded with life insurance and there are many shareholders, a stock redemption agreement is easier to administer than a cross-purchase because only one policy on each shareholder's life is required. Another advantage is that the company can absorb premium differences associated with age or health disparities among shareholders.

   The company won't recognize income for tax purposes when it receives the insurance proceeds. In cases of redemption agreements, consider the effects of the entire transaction — proceeds received and redemption accomplished — on the company's profits. Profits will increase with the life insurance proceeds received and decrease as a result of the stock redemption.

   A disadvantage of redemption agreements is that remaining shareholders don't receive the benefit of a step-up in basis when the company purchases the deceased shareholder's interest. The continuing shareholders retain their original basis in the company. This means that, compared to the cross-purchase agreement, the redemption agreement will create greater potential capital gains if the business is subsequently sold.

   After the stock redemption is accomplished, however, the corporate assets should be relatively unchanged. (The insurance proceeds have been used to purchase the deceased's interest.) But each owner now benefits from a greater percentage of ownership.

The best agreement for your business will depend on a number of factors, including its business structure, its financial status, and the individual needs and circumstances of all its owners.

## Safe and sound

Designing and implementing a buy-sell agreement can be an effective tool for outlining your wishes for your company when you or a co-owner departs. Using one can help preserve a company's control and ensure a financially sound future for its owners and their loved ones. ■

# Measure fund performance by total return, not NAV

You log onto your computer one morning to check your mutual fund prices, only to discover that your fund's net asset value (NAV) plunged overnight.

You might worry that this significant drop signifies trouble with your investment, but it's not necessarily a cause for alarm. In fact, this happens fairly routinely, and you'll find that tracking your fund's NAV is an imperfect way to evaluate your investment performance over time. Your fund's total return provides a better scorecard of your gains and losses.

## NAV not the same as stock price

Part of the confusion over NAV stems from a key difference between how stocks and open-end mutual funds are priced. A stock's price and a fund's NAV both reflect how much you must pay for one share of that investment. But the similarity ends there.

Stock prices fluctuate throughout the day according to supply and demand, but an open-end mutual fund is priced once per day, with its value reflecting the combined value of its underlying assets. What's more, while only a fixed number of stock shares trade on the open market, fund companies continually issue new shares as their customers add money to their investments.

A fund's NAV reflects its net assets: NAV = (fund assets – fund liabilities) / number of shares outstanding. For example, consider Fund ABC, with assets of $100 million, liabilities of $15 million and 1 million outstanding shares. The fund's NAV — its price per share — is $85.

## Distributions lower NAV

NAV can be an especially poor way to track gains and losses. Generally, if a fund's assets drop, its NAV will drop, too. But not all net asset declines are a negative event for shareholders. For example, whenever you receive a distribution from your fund — such as capital gains or dividend payments — it leads to a corresponding NAV decline. In fact, the larger the distribution, the larger the drop in NAV.

Continuing with the previous example, let's say that at year end Fund ABC distributes a combined $4 million of dividends and capital gains to shareholders. This distribution reduces net assets from $85 million to $81 million. With 1 million fund shares outstanding, Fund ABC's NAV declines by nearly 5%, or from $85 to $81.

But this doesn't make your investment worth 5% less, any more than taking money from your wallet and putting it in your bank account lowers your overall net worth. Even though the price of each fund share falls by $4, you either own more shares of the fund (if you're reinvesting dividends and capital gains) or you receive the difference in cash.

## Track results with total return

Rather than tracking changes in NAV over time, consider total return as a way to measure your fund's long-term performance. Because total return, which is readily found on financial Web sites and in newspaper mutual fund listings, includes the value of dividend and capital gains distributions, it provides you with a fuller picture of your investment's overall results. ■

# Your source for customized investment and financial planning

CFSE
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Successfully managing personal and family finances means making the right decisions today while considering their implications for the future. At CFSE Wealth Management, our sole focus is our client's best interest, and we customize portfolios and financial plans to fit each individual's set of goals and objectives.

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- Portfolio Management
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- Access to your portfolio anytime, anywhere through online services

**James W. Ferrell, MBA, CPA, PFS, CIMC**
**President**
A Certified Public Accountant (CPA), Personal Financial Specialist (PFS) and Certified Investment Management Consultant (CIMC), Jim is the founding shareholder and President of CFSE Wealth Management, Inc.

Jim is actively involved in local organizations including: Morning Star Charities, Inc. (President), Winter Park Chamber of Commerce, the University of Central Florida Golden Knights Club, Winter Park YMCA (Board of Directors), on the Center for Entrepreneurship at Rollins College (Board of Directors) and is an Inductee in the UCF College of Business Administration Hall of Fame.

**Katie Miller, MBA**
**Vice President - Financial Advisor**
A Certified Financial Planner (CFP) candidate with a Master of Business Administration Degree from Rollins College, Katie works as a financial advisor responsible for assisting clients set and achieve their long-term financial goals through investments, tax planning, asset allocation, risk management, retirement planning, and estate planning.

Katie is a member of the Winter Park Community Foundation Advisory Board, the Winter Park Chamber of Commerce and Orlando Chamber of Commerce.

By working with our experienced team of advisors, you will benefit from the independent and objective perspective necessary to make your financial vision a reality.

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