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THE KELEMEN-WAY FINANCIAL PERSPECTIVE

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Are You Getting Your Breakpoints on Mutual Fund Purchases?

If you purchased a class A Share of a mutual fund from 1999 through November 2003, chances are you have received a letter and a claim form in the mail from the firm that sold you the fund. The NASD (the self-regulatory organization of broker-dealers) directed nearly all brokerage firms and mutual fund companies to send a letter to this effect, so you may have received nearly identical letters if you have done business with more than one firm.

Based on the many comments we have heard (or overheard) from clients, acquaintances, and colleagues, many people seem confused. Much of this confusion, I believe, comes from the claim form itself—its very presence suggests to investors that they are owed a refund.

So what is a breakpoint?

Breakpoint discounts reduce the front-end sales charge you pay when you purchase certain mutual fund shares (those funds with an up front sales charge). These discounts are based on the cumulative size of your investment with any one mutual fund family. They may begin at as little as $25,000 invested, although they typically begin at investment levels of $50,000; discounts are then given at $100,000, $250,000, and higher. A 5% front-end load for a $10,000 mutual fund purchase may be reduced to 4.25% for a $50,000 purchase, for instance, and to 0% for a $1 million purchase.

How did this come about?

In 2003, the NASD conducted a survey of 43 of the larger registered broker dealers in the US and concluded that most firms did not uniformly offer the breakpoint discounts to customers. Overall, discounts were not delivered in about 20% of eligible transactions. The NASD estimates that at least $86 million is owed to investors for 2001 and 2002 alone.

Are You Eligible?

To determine your eligibility, you need to tally up all your holdings from any single mutual fund company, regardless of where you purchased them. If you make an outright purchase of a Class A mutual fund, it seems pretty straight forward, and we believe most brokers are very conscientious in that regard. If the total amount of all funds you purchased from the same fund company was less than $25,000, you probably are not eligible.

But it gets confusing because mutual fund families differ on their rules. Some loads are lower, so the breakpoints are higher. Some allow the discount based upon your purchase prices, not current market value. Most confusing, however, is that, the mutual fund families allow you to aggregate all of the holdings you or any family members may have with them. The questions is, how do you define "family" and what types of accounts are eligible?

Some fund families allow only immediate family members and their dependents. Others may go beyond the nuclear family. And some allow you to include your employer-sponsored 401-k holdings, while others may not. And don't forget any variable annuity sub accounts managed by the same fund family. **It may be difficult for the broker to keep track of all these exceptions, and impossible if you don't share with him or her where you have all of your accounts!**

You may have also received the letter even if you paid no commissions through a fee-based "wrap" account. Most of these types of accounts allow you to purchase load funds with the load waived in lieu of the annual fees you pay for the wrap service and advice. So in effect, you got the ultimate discount on those—if your funds were purchased at net asset value (NAV) with no load deducted, as in the case with our wrap accounts

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Financial Planning Numbers for 2004

Between inflation adjustments, phase-ins, and tax law changes last year, we start 2004 off with many significant changes in tax rates, thresholds, and retirement plan contribution amounts. So here are some handy references on some of the more significant changes to assist you with your financial planning during 2004.

Income Taxes

Your tax bracket is important because it determines the relative value of one investment over another and the timing of when to liquidate an investment or take a withdrawal from a retirement plan. Interest income, bond interest, and dividends from real estate investment trusts are taxed at your tax bracket rate. The decrease in personal income tax rates may make tax-free bonds less attractive and give an edge to higher-yielding taxable bonds.

2004 MARGINAL INCOME TAX RATES

Single	Married	Marginal Federal
Taxable Income Over:		Tax Rate*
$0	$0	10%
$7,150	$14,300	15%
$29,050	$58,100	25%
$70,350	$117,250	28%
$146,750	$178,650	33%
$319,100	$319,100	35%

Source: IRS Revenue Bulletin 2003-49

* If you can fog a mirror, your Oregon bracket is 9%.

Two very important parts of figuring your taxable income are the itemization of your deductions (such as property taxes, contributions, and mortgage interest) and your personal exemptions (now $3,050). They both become less valuable after your AGI (adjusted gross income—the bottom line of page 1 of your 1040) exceeds $142,700 for singles and $214,500 for couples. Also, the Alternative minimum tax (AMT) exemption remains unchanged in 2004: $58,000 (joint) and $40,250 (single). These calculations are best left to your tax professional.

Social Security (FICA) Tax

Your first $87,900 (up from $87,000) of employment income is subject to FICA at the rate of 7.65%, paid by you and 7.65% by your employer (which could also be you). There is no wage limit for Medicare; so all employment income above $87,900 is taxed at 1.45%.

Social Security Benefits

Social Security benefits are taxed based on your "combined income," which is your AGI plus tax-free bond interest, plus 50% of your Social Security Benefits.

TAX ON SOCIAL SECURITY BENEFITS

Joint Combined Income*	Single Combined Income*	Amount of benefits subject to tax
$32,000-$44,000	$25,000-$34,000	50%
Over $44,000	Over $34,000	85%

Source: www.socialsecurity.gov

Investments

Capital gains on assets held over one year are now taxed at 15% (plus 9% for Oregon). It's only 5% for those in the 10% and 15% brackets. Most dividends are now taxed at 15%, instead of at ordinary rates. Dividends from retained earnings from your closely-held businesses may also be treated more favorably, but be sure to work closely with your tax professional on this.

Estate Taxes

Starting in 2004, you can give away $1.5 million gift tax free (previously $1 million), either as lifetime gifts or as a part of your estate. Double that if you are married. However, if the sunset provisions on the 2001 law are not repealed, and you die in 2011 or later, the exemption falls back to $1 million per person. Given our Federal budget deficit and the baby boomers entering retirement, we wouldn't count on the repeal. So plan your estate accordingly. You can still give $11,000 each year gift tax free to anyone; $22,000 for married couples.

The "Kiddie" Tax

Between the new higher standard deduction of $800 for a child who is claimed as a dependent, and the higher "Kiddie" tax exemption of $800, children under 14 can now earn up to $1,600 without it being taxed at the parents' tax rate.

Retirement Plans

Many of the retirement plan contribution limits went above their inflation thresholds for 2004 after remaining unchanged for a couple of years.

RETIREMENT PLAN CONTRIBUTION LIMITS

Max compensation base used to calculate contribution % to most retirement plans	$205,000
Max contribution to defined contribution plans (401(k), profit sharing, SEP IRA, etc.)	$41,000
401(k), 403(b), 457(b) plans elective deferrals	$13,000
Catch-up provisions for those over 50 (over and above the $13,000)	$3,000
SIMPLE IRA plans, elective deferral limit	$9,000
SIMPLE IRA plans, catch-up provisions for those over 50	$1,500
Fully Deductible IRA (if not covered by other retirement plans, or if so, joint AGI is <$65,000; $45,000 single.)	$3,000
Roth IRA (if joint AGI <$150,000; $95,000 single)	$3,000
Traditional & Roth IRA catch-up provisions for those over age 50	$ 500

Source: IRS Announcement 2003-122 and Publication 590

Other Changes

Use these numbers for approximations and rough calculations, or in the case of retirement plan contribution limits, as a goal or budgeting number. Many other changes take place this year, but they are either smaller in nature, or may not necessarily apply to most readers of *The Kelemen-Way Financial Perspectives*. There is no substitute for good tax, legal, and financial planning advice, so we encourage you to seek it from a qualified professional.

The US Dollar, Trade, and Election-Year Politics

If you've traveled to Europe recently, or paid any attention to the news, you no-doubt have experienced or heard about the weak US dollar. But what you may not have heard is that in the Americas or in Asia, where the currencies are generally pegged to the US dollar, the dollar is about where it was a year ago.

The value of the dollar is very important to some sectors of our economy and for certain stocks and bonds in the financial markets. **A lower dollar makes our exports cheaper for other countries to buy. Our economy would be worse off if our exporting companies didn't have this currency advantage.** But it is a double-edged sword, because it makes imports more expensive. So, a lower dollar could actually be inflationary for many items, possibly triggering higher interest rates.

The principal concern with a weaker dollar is when foreigners stop buying bonds, our biggest export. These foreign savings support our trade and budget deficits. This didn't matter much when we had a budget surplus, or when the deficits were small. But those days are over, and the deficits continue to grow.

The glue that holds our complex system of world finance together is trade. And trading partners rarely go to war against one another. Yes, trade needs to be fair, but the devil is in the details. What is fair to an American auto manufacturer in Detroit (lower imported steel prices) is not fair to a domestic steel producer in Pennsylvania.

This is an election year, so we are going to hear a lot of rhetoric about trade and jobs. Remember, **no** politician in **any** party can wave a magic wand to solve these problems. As you head to the polling booth, remember that most historians agree that it was not the stock market crash of 1929 that caused the Great Depression. Rather, it was the passage of the Smoot-Hawley Tariff Act, which set up many trade barriers, causing our trading partners to retaliate. It could be so much worse this time, given the volume of international trade and the interdependence of our global community.

Eager To File Your Tax Return?

Changes in the tax law last year created new lower rates on capital gains and dividends after May 5, 2003. It also created a lot of headaches for those companies that have to report the nature and timing of those gains and dividends. Not all dividends receive this favorable treatment. As a result, many mutual fund companies and brokerage firms are sending corrected 1099 statements. **Unless you want to pay extra accounting fees to amend your return, we recommend that you get it ready, but hold off on finalizing it until late March.** The odds are high that you will receive a corrected 1099 on interest and dividends.

Are You Getting Your Breakpoints ... **continued from page 1**

managed through The H Group, Inc. or through the Preferred Asset Management (PAM) program through Financial Network.

The Real Issues

We believe that the real issues may not be the breakpoint discounts you missed because your accounts were spread all over the place with different firms or because of the different rules of each fund family. The real issues, in our opinion, are two-fold:

1. You may have missed the break point discounts because your broker divided your account between different fund families so that you would not have enough invested in any fund family to get the full discount to which an account of that size would be entitled. This is very commonly done, sometimes in the name of diversification.
2. Maybe you got your breakpoints by staying mostly in one fund family. But if the fund family is sponsored or underwritten by the parent firm of your broker or one of its affiliates, you may not be getting a "breakpoint" on objective advice.

If you have concerns about any of these issues, we would welcome the opportunity to discuss them with you in greater detail.

THE KELEMEN-WAY ADVANTAGE

Ron Kelemen and Mary Way are independent Certified Financial Planner™ certificants and jointly serve their clients as a team. Their fee-based practice focuses on wealth planning and management for professionals, business owners, and retirees. Together, they have developed The Planning Vision Process® and several other unique processes. They are both advisory associates of The H Group, Inc., one of the largest independent fee-based registered investment advisory firms in the Northwest with 18 professionals and over $300 million under active management. They are also registered with Financial Network Investment Corporation, (unaffiliated with the H Group, Inc.) a national broker-dealer with offices throughout the United States, Member SIPC.

About Ron Kelemen, CFP®

In practice since 1981, **Ron Kelemen, CFP®**, is a contributing author of the definitive book on retirement planning: *Ways and Means: Practical Answers from America's Foremost Financial Advisors and Retirement Planning Attorneys*. His other contributory book, *Strictly Business—Planning Strategies for Privately Owned Businesses*, is now available from Ron or Quantum Press. He is Vice President of the Willamette Valley Estate Planning Council, active in several local charities, and is frequently quoted in national the press.

About Mary Way, CFP®, CPA

Mary Way, CFP®, CPA is a professional team member on Ron's team for over nine years. She is also a non-practicing CPA with 16 years experience in banking, business, and finance. She is active in Salem Rotary, the Financial Planning Section of the Oregon Society of CPAs, The Oregon Financial Planning Association, and The Willamette Valley Estate Planning Council.

Team Update

Like most Oregonians, we started off the year in the midst of a two-week snow and ice storm. It made us all appreciate the importance of heat, hot water, electricity, cable connections, and the ability to move about freely on roads—and even sidewalks. All of the preparations we had made in 1999 for Y2k paid off, except that we now have more powerful back up batteries for our computer system and phones. Our recent Internet-based data system enabled us to work remotely and take care of portfolio administration and management without disruption.

Debbie Renggli and husband Bob visited their son Pete at Embry-Riddle University in Arizona. He recently received his commercial helicopter license, so if you're looking for a good pilot.... They also had a chance to see the Grand Canyon before the summer tourist mobs.

Lani Moore continues to remain very busy with her children and grandchildren.

January is always a big continuing education month. **Mary** attended the two-day Oregon & SW Washington FPA conference in Portland. She also attended the Portland Estate Planning Council's all-day conference with **Ron**. She was also elected to the Board of Salem Rotary. Much of Mary's and husband Steve's time and energy has been directed toward finding care for Steve's aging parents in Olympia.

Ron completed the draft manuscript for his share of his next contributory book, *Living and Learning,* about retirement and education planning, to be published in June 2005 by Quantum Press. Ron also had a lengthy article on practice management published in *Morningstar.com.* He attended Strategic Coach in Chicago and an advanced planning conference in Las Vegas. In early February, he had surgery and two nights in the hospital for a broken tibia at the ankle, following a snowboarding injury in Utah. He'll still have a cast and crutches until at least late March. He is slowly coming to realize that at his age on a snowboard, black diamonds—or even the blue square trail makers—may not be forever.

The Results are in!

During November and December we conducted a third party survey of our service and client satisfaction through Advisor Impact, a strategic partner with Moss Adams, LLP.

The response rate was 58%—well above Advisor Impact's normal response rate of 36% and surveys in general. **We are pleased and honored that our clients gave us an overall satisfaction rating of 4.9 out of a possible 5.0—**one of the highest ever seen by Advisor Impact. Most importantly, we received a score of **5.0 on trustworthiness,** which is the category we believe matters the most. Other key scores:

• Confidence in the skills of the administrative team	4.9
• Advisor understands my situation	4.7
• Treated as a valued client	4.9
• Problems handled quickly and professionally	4.9
• Receive good value for the fees paid	4.7
• Would recommend us to others	4.8

But we want to get even better. Therefore, we plan to implement some specific client suggestions the survey identified to further improve our service in 2004. Thanks again to all of you who took the time to participate.

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The Kelemen-Way Financial Perspective

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What Matters More To Your Portfolio?

We are sometimes asked whether the rate of return on investments or how much one saves is more important in building and preserving a portfolio. The answer depends upon your age and the size of the portfolio. For everybody, starting early makes a huge difference. **How much you save in earlier years is more important that your rate of return.** Never underestimate the power of compound interest over a long period of time. **But return becomes more important as your account balance grows. Finally, losses matter more in the early years of retirement.** It's really just a matter of the mathematics of leverage.

For example, let's say you are starting out with $10,000. Even a 10% investment return increases it by only $1,000. But if you added $5,000, the account increases to $15,000—a 50% increase! Now let's pretend the account is worth $100,000. A 10% return increases it by $10,000, whereas the $5,000 addition increases it by only 5%.

If the initial $10,000 lost 10% the first year, it would be worth $9,000. And if you are young, you have time to make that difference up, especially by adding to it every year. But a 10% loss on the $100,000 account costs $10,000. If you were retired and withdrew $5,000 from that $90,000 balance, you would need to earn over 17% to get back to $100,000.

EFFECTS OF INVESTMENT, WITHDRAWAL, GAIN OR LOSS ON PORTFOLIO SIZE

Portfolio Size	$5,000 Investment	$5,000 Withdrawal	10% Return	10% Loss
$10,000	50% increase	50% decrease	$1,000 gain	$1,000 loss
$100,000	5% increase	$5% decrease	$10,000 gain	$10,000 loss
$1,000,000	0.5% increase	0.5% decrease	$100,000 gain	$100,000 loss

"For illustrative purposes only. This does not reflect the performance of any specific investment scenario."