

Investment Risks & Possible Risk Aversion Strategies:

- **Lack of Liquidity**

Investors should keep some money available in liquid investments that can provide a cushion for those rainy days. As a general rule of thumb, liquid cash should equal approximately 6 months salary (after taxes). A money market fund allows you access to money when you need it. In addition, by investing your “available” cash in a money market fund, it will earn dividends until you need it.

- **Loss of Part of Your Original Investment**

Investments fluctuate, but some investments are clearly safer than others. Investments that offer guaranteed fixed interest rate may provide more stability and less risk of loss of your original investment. However, short-term fluctuations can effect even high-quality long-term investment. Careful diversified investment can mitigate some of the market fluctuations.

- **Inflation**

Inflation occurs when the “actual” value of money goes down because of the price of goods and services going up. Equity investment or investment in real estate has historically proven to be a safer way to hedge against inflation eroding your investments.

- **Falling Prices**

Disinflation or a slowing rate of inflation is caused when prices increase at a slower rate. While disinflation can be good news for day-to-day costs, it can be bad for the interest rates of your investments. As inflation slows, interest rates fall.

- **Possible solution:**

- Fixed Annuity, Long Term Bonds**

- A long-term bond represents a contractual obligation of the issuer. An individual who purchases a long-term bond is actually lending money to the issuer, while receiving interest on the loan, along with an agreement to pay back the principal at a stated date in the future. By investing in long-term bonds or fixed annuities, your rate is “locked in”. This becomes critical when interest rates are declining because you have already established your set rate. Compare this to a one year Certificate of Deposit where your rate would change after that one year. If rates have dropped you would then earn the lower rate.

- **Paying Too Much Income Tax**

When many individuals invest, their primary objective is to seek an investment that will maximize their return; many investors overlook the impact of taxes on their

investment return. If you consider that state and federal income taxes can easily wipe out almost one-third of your investment return, taxes become a very important consideration in the investment decision-making process.

➤ **Possible solution:**

Retirement Accounts, Annuities and Municipal Bond Funds

Reducing or eliminating current income taxes on your investment could be one solution to making the most of your investment dollars. This can be achieved through the power of tax-deferral or tax-free investing.

Examples of tax-deferred investments are:

Individual Retirement Arrangements

Traditional IRA – A long-term retirement vehicle which allow you to contribute \$4,000 or 100% of your compensation annually, whichever is less. Contributions may be deductible for federal income tax purposes, depending on whether you are an active participant of an employer sponsored retirement plan

Roth IRA – A long-term retirement vehicle which allows you to contribute \$4,000 or 100% of your compensation, whichever is less. Generally, distributions from a Roth IRA are income tax free if the Roth IRA has been held for 5 years and:

1. is taken after attaining age 59 1/2
2. occurs due to death or disability
3. meets the criteria for a qualifying first time home buyer distribution

Annuities – These are long-term retirement vehicles that allow your investment returns to accumulate tax-deferred, while also providing a variety of income payments. There are two variations of annuities, fixed and variable. A fixed annuity will provide a fixed rate of interest guaranteed by the issuing insurance company for a specified period of time. A variable annuity allows you to invest in sub-accounts, which invest in a series of underlying funds. Generally, these underlying funds will range anywhere from money markets, to growth funds, to aggressive growth funds. Due to the nature of these investments, your contract value will fluctuate with the performance of the underlying investment.

Tax-Free Investment

Municipal Bonds and Municipal Bonds Funds – These are bonds issued by states, cities, or counties other than the federal government or its agencies. What makes Municipal Bonds so attractive, especially to investors in a high tax bracket, is they are exempt from federal income tax. Due to this feature, the interest rate offered on municipal bonds will be lower than non-exempt bonds.

● **Politics & Economics**

Periods of political or economic turmoil will often have an adverse affect on U.S. investment markets. Recent circumstances such as the Iraq war, oil crisis, or economic indicators that suggest a slowing economy all may influence temporary declines in U.S. financial investments like stocks and bonds.

➤ **Possible solution:**

International Investments

Investing in stocks and bonds that invest in foreign markets and economies may ease some of the volatility you may experience in your portfolio, because the foreign countries may experience different economic cycles than the United States. International investing may also provide opportunity that can not be achieved by only investing in U.S. companies. Many of the world's largest companies are based outside the United States.

● **Premature Death**

Now more than ever, families rely on dual incomes to maintain their standard of living. Without proper protection, the loss of income from the premature death of a family member may seriously jeopardize a family's ability to maintain their current lifestyle and meet current and future costs, such as a mortgage, utilities, college tuition, and retirement savings.

➤ **Possible solution:**

Life Insurance

It may be the most appropriate vehicle available to protect a family from the premature death of an important family member. The nature of life insurance provides for the tax-deferred build up of cash values, while leveraging the amount of money contributed to the policy by paying an income tax-free death benefit. There are many different types of life insurance policies available today. It is always important to consider your overall financial and investment needs and objectives to ensure you purchase a life insurance policy that is most suitable to meet your goals.

● **Unexpected Disability**

Most people realize the importance of health or medical insurance to cover the costs of possible accidents or illness, but many people don't consider the potential loss of income associated with periods of disability. However, for people of most ages the possibility of becoming disabled due to an accident or injury is more probable than the possibility of death.

➤ **Possible solution:**

Disability Insurance

This type of insurance is usually most suitable for people under the age of 65, who desire protection from the loss of income due to disability. The provisions of Disability Insurance will vary depending on the policy, but generally speaking, disability insurance will provide a monthly benefit ranging between 60% to 80% of a person's earned income.

Long-Term Care Insurance

Long-Term Care Insurance is another form of disability insurance generally geared toward older people who wish to protect their asset base from the high costs incurred from home health care or a nursing home facility. It also allows people the flexibility to choose their own form of nursing care, and not the care dictated by a government program.

- **Losing Part of an Estate Due to Taxes**

Federal estate tax is an excise tax levied on a person's right to transfer property upon his or her death. An individual's estate tax could range between 37% to 55% (1) of a person's taxable estate. A tax of this magnitude could significantly reduce the amount of money transferred to your heirs, as well as place a burden on the estate if there are not enough liquid assets available to pay the tax.

There is some relief from tax. In 2005, taxable estates of \$1,000,000 or less are generally not affected by estate taxes due to the unified credit granted to individuals. Each individual has a unified credit that may be used to offset estate taxes on the first \$1,000,000 of their taxable estate (2). Any amount of taxable estate exceeding the first \$1,000,000 would then be subject to federal estate tax. (3)

(1) Estates in excess of \$10,000,000 may be subjected to an additional 5% surcharge.

(2) \$1,000,000 is available in 2005, assuming the unified credit has not already been used to offset gift tax. This amount will change in future years.

(3) Estates may also be subject to state estate or inheritance taxes. For additional information regarding estate taxation, please contact a tax attorney or professional tax advisor.

➤ **Possible solution:**

Estate Planning

Estate planning can be a complicated matter, especially with larger estates. A properly drafted will may be the first very important step in this process. This can ensure that your assets are transferred according to your wishes.

The following are a sample of some of the strategies that may be used to reduce the size of your estate.

Gift Program – Individuals may make an \$11,000 annual gift per person without gift tax consequences. This means spouses may make a combined \$20,000 annual gift. If you are married and have three children, you could gift a total of \$66,000 a year, directing \$22,000 to investments established in each child's name.

Irrevocable Life Insurance Trust – A last survivor life insurance policy may be one choice used to fund the trust. Because the irrevocable life insurance trust is the owner of the life insurance policy, it will not be included in your estate (4). Additionally, paying the premium on the life insurance policy will further reduce your estate, while providing an income tax free death benefit payable to the trust upon the death of the last surviving spouse. You may have the trust drafted to

instruct the trustee to use the proceeds of the death benefit to pay any estate taxes that may be due or to distribute this money to the named beneficiaries of the trust.

Gifts of Life Insurance Policies made within 3 years of death may be included in the gross estate of the transferor.

- **Psychological Risk**

Psychological risk is the risk that you invest in something that causes you stress or concern about your investment. If for example, you purchase a long-term investment that is much more volatile than you expected, you may be less likely to hold that investment to the full term of your initial strategy. A situation like this may be worse for your overall financial situation than the actual risk you were trying to protect yourself from. In some cases, you may never be comfortable with a suggested investment. You should seek alternative investment methods to meet your financial goals and only make decision that you are comfortable with, and that you think is best