



The Strategic Advisor

Strategies for Success

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It is my pleasure to be able to provide information that can aid you in building your financial future. I hope you enjoy the content and find it helpful.

If I can be of assistance please feel free to call. We can discuss any of your concerns without obligation.

Wishing you well, as you travel the road to financial independence.

In this issue:

Strategies for Handling Market Volatility

Inheriting a 401(k) Plan Account

Understanding the Alternative Minimum Tax (AMT)

Ask the Experts

Strategies for Handling Market Volatility

Keeping your cool can be hard to do when the market goes on one of its periodic roller-coaster rides. It's useful to have strategies in place that prepare you both financially and psychologically to handle market volatility.

Have a game plan against panic

Having predetermined guidelines that anticipate turbulent times can help prevent emotion from dictating your decisions. If you're an active investor, a trading discipline can help you stick to a long-term strategy. For example, you might determine in advance that you will take profits when the market rises by a certain percentage, and buy when the market has fallen by a set percentage. Or you might take a core-and-satellite approach, combining the use of buy-and-hold principles for the bulk of your portfolio with tactical investing based on a shorter-term market outlook. You can use diversification to offset the risks of certain holdings with those of others. Diversification may not ensure a profit or guarantee against a loss, but it can help you understand and balance your risk in advance.



Consider playing defense

Many investors try to prepare for volatile periods by reexamining their allocation to such defensive sectors as consumer staples or utilities (though, like all stocks, those sectors involve their own risks). Dividends also can help cushion the impact of price swings.

Use cash to help manage your mindset

Cash can be the financial equivalent of taking deep breaths to relax. It can enhance your ability to make thoughtful decisions instead of impulsive ones. If you've established an appropriate asset allocation, you should have

enough resources on hand to prevent having to sell stocks to meet ordinary expenses or, if you've used leverage, a margin call.

A cash cushion coupled with a disciplined investing strategy can change your perspective on market downturns. Knowing that you're positioned to take advantage of a market swoon by picking up bargains may increase your willingness to be patient.

Know what you own and why you own it

When the market sneezes, knowing why you originally made a specific investment can help you evaluate whether those reasons still hold, regardless of what the overall market is doing. If you don't understand why a security is in your portfolio, find out. A stock may still be a good long-term opportunity even when its price has dropped.

Remember that tomorrow is another day

The market is nothing if not cyclical. Even if you wish you had sold at what



turned out to be a market peak, or regret having sat out a buying opportunity, you may well get another chance at some point. Even if you're considering changes, a volatile market is probably the worst time to turn your portfolio inside out. A well-thought-out asset allocation is still the basis of good investment planning.

Be willing to learn from your mistakes

Anyone can look good during bull markets; smart investors are produced by the inevitable rough patches. Even the best aren't right all the time. If an earlier choice now seems rash, sometimes the best strategy is to take a loss, learn from the experience, and apply the lesson to future decisions.

A financial professional can help prepare you and your portfolio to both weather and take advantage of the market's ups and downs.



You can't leave money in a 401(k) plan or IRA forever. The federal government requires that you begin taking distributions (called "required minimum distributions," or RMDs) after the participant's death. In general, if you roll 401(k) funds into an inherited IRA, you'll be able to take these RMDs over your life expectancy. But if you're a nonspouse beneficiary, and the 401(k) plan requires that you take distributions within 5 years after the participant's death, be careful--if the participant died before age 70½, you'll need to complete your rollover to the inherited IRA by the end of the year following the year of the participant's death. If you don't, you won't be able to take distributions from the inherited IRA over your life expectancy. Instead, you'll have to withdraw all the funds from the IRA by the end of the 5th year following the participant's death.

Inheriting a 401(k) Plan Account

When you inherit a 401(k) plan account, the options available to you depend on a number of factors, including the terms of the 401(k) plan and your relationship to the deceased 401(k) plan participant. In general, you'll have four options: take an immediate distribution, disclaim all or part of the assets, leave the money in the 401(k) plan (if the plan permits), or roll the funds over to an IRA.

Should you take the cash?

Obviously, if you need the funds immediately, taking a lump-sum distribution from the 401(k) plan may be your only viable alternative. But you'll have to pay ordinary income tax on the distribution (except for the amount of any after-tax contributions and qualified Roth distributions). Special tax rules may apply if the plan participant was born before January 2, 1936--consult a tax professional for details.

A lump sum might also be attractive if you're entitled to a distribution of employer stock. You may be able to pay ordinary income tax on just the participant's basis in the stock, and defer tax on the appreciation (called "net unrealized appreciation," or NUA) until you sell the stock in the future--at capital gain rates.

What's a disclaimer?

When you disclaim (i.e., refuse to accept) 401(k) assets, they pass instead to the plan participant's contingent beneficiary, or estate if there is no contingent beneficiary. In general, you must give the plan written notice of your intent to disclaim the funds within nine months after the participant's death. But be careful not to exercise control over the funds in the meantime (for example, by choosing a distribution option or by exercising investment control), or you may lose your ability to disclaim the funds.

A disclaimer may be an attractive option if you're sure you won't need the funds, and the transfer to the contingent beneficiary makes good economic and estate planning sense.

The problem with 401(k) plans

If you're like most beneficiaries, your goal will be to stretch payments out as long as possible, taking full advantage of the tax deferral offered by retirement plans. This means either

leaving the assets in the 401(k) plan, or rolling them over to an IRA.

For most, leaving the funds in the 401(k) plan isn't the best choice for two reasons. First, the investment alternatives available to you in a 401(k) plan are limited to the ones selected by the employer. Second, the distribution options offered by a 401(k) plan typically aren't as flexible as those available in an IRA. In fact, many 401(k) plans require beneficiaries to take distributions shortly after the participant's death.

Roll the funds over to an IRA

Unless the 401(k) plan offers a unique investment alternative, rolling the 401(k) assets over to an IRA will usually be your best choice. IRAs offer virtually limitless investment options. And when it comes time to take distributions from the plan, IRAs offer the most flexible payment provisions. But, before deciding on a rollover, make sure you understand any fees and expenses that may apply.

If you're a surviving spouse, you'll have to decide between rolling the funds over to your own IRA, or to an IRA that you establish in the participant's name, with you specified as the beneficiary (this is referred to as an "inherited IRA"). Which should you choose?

In most cases, you'll be better off rolling the funds over to your own IRA. Rolling the funds over to an inherited IRA is typically appropriate only if you're not yet age 59½ and you think you'll need the funds before you reach that age. That's because distributions from an inherited IRA aren't subject to the 10% early distribution penalty tax. (In contrast, distributions from your own IRA before age 59½ are subject to the 10% penalty tax unless an exception applies.)

If you're not the surviving spouse, you don't have the option of rolling the 401(k) assets over to your own IRA. But thanks to the Pension Protection Act of 2006, you may be able to make a direct rollover of the 401(k) funds to an inherited IRA. A 401(k) plan isn't required to offer this option, so check with your plan administrator. This new rule applies to distributions you receive after 2006.

The rules governing inherited 401(k) plan accounts are complex. A financial professional can help you sort through the alternatives, and make the decision most appropriate for your individual circumstances.



Understanding the Alternative Minimum Tax (AMT)

If you aren't already familiar with the individual alternative minimum tax (AMT), there's a good chance that you soon will be. Because its key figures aren't indexed for inflation, the AMT reaches further into the ranks of middle-income Americans each year. And because temporary legislative band-aids expired at the end of 2006, the stage is set for a dramatic rise in the number of individuals who are affected.

What is the AMT?

The AMT is essentially a separate federal income tax system with its own tax rates and its own set of rules governing the recognition and timing of income and expenses. If you're subject to the AMT, you have to calculate your taxes twice--once under the regular tax system and again under the AMT system. If your income tax liability under the AMT is greater than your liability under the regular tax system, the difference is reported as an additional tax on your federal income tax return.

AMT rates

Under the AMT, the first \$175,000 of taxable income (\$87,500 if married filing separately) is taxed at a rate of 26%. Taxable income above this amount is taxed at a flat rate of 28%.

How do you know if you're subject to the AMT?

Part of the problem with the AMT is that, without doing some calculations, there's no easy way to determine whether you're subject to the tax. Key AMT "triggers" include the number of personal exemptions you claim, your miscellaneous itemized deductions, and your state and local tax deductions. So, for example, if you have a large family and live in a high-tax state, there's a good possibility you might have to contend with the AMT. IRS Form 1040 instructions include a worksheet that may help you determine whether you're subject to the AMT (an electronic version of this worksheet is also available on the IRS website), but you might need to complete IRS Form 6251 to know for sure.

AMT adjustments

Differences between the regular and AMT calculations include:

- The standard deduction and deductions for personal exemptions are not allowed for purposes of calculating the AMT.

- Under the AMT calculation, no deduction is allowed for state and local taxes paid, or for certain miscellaneous itemized deductions.
- Under the AMT calculation, any deduction for medical expenses may also be reduced, and qualifying residence interest (e.g., mortgage or home equity loan interest) can only be deducted to the extent the loan proceeds are used to purchase, construct, or improve a principal residence.
- Special AMT treatment applies to the exercise of incentive stock options (ISOs) and to the treatment of certain depreciation deductions.



AMT exemption amounts

While the AMT takes away personal exemptions and a number of deductions, it substitutes a specific AMT exemption amount. The AMT exemption amount that you're entitled to depends on your filing status and income (AMT exemption amounts are phased out for individuals with higher incomes). A patchwork of legislation since 2001 has, along with other AMT provisions, pumped up AMT exemption amounts to stave off a spike in the number of taxpayers caught in the AMT "net." The bad news, though, is that the last legislative patch expired at the end of 2006. Unless Congress passes new legislation, 2007 AMT exemption amounts return to pre-2001 levels, and the number of taxpayers subject to AMT is expected to skyrocket.

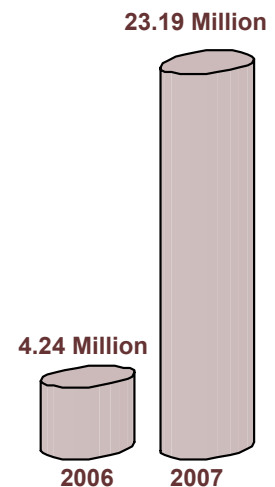
Legislative outlook

Several bills have been introduced in the current Congress relating to the AMT. Proposals range from another one-year patch to full repeal. The problem with repealing the AMT is that it would leave a significant revenue gap (the Joint Committee on Taxation projects that the AMT will account for almost \$25 billion in revenue for the 2006 tax year). That means we're more likely to see another short-term fix than we are to see substantive reform.

Summing up

Owing AMT can be an unpleasant surprise. It also turns a number of traditional tax planning strategies (e.g., accelerating deductions) on their heads, so it's a good idea to factor in the AMT before the end of the year, while there's still time to plan. If you think you might be subject to the AMT, it's worth sitting down to discuss your situation with a tax professional.

How Many Taxpayers Will Be Affected by the AMT?



Projection by the Joint Committee on Taxation, March 5, 2007



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Ask the Experts



What are convertible preferred shares of stock?

Convertible preferred shares of stock are one way to have some of the best of what both stocks and bonds have to offer. Like bonds, they attract investors who want a steady income. However, this type of preferred stock also gives the holder the option of exchanging some or all of those preferred shares for shares of common stock in order to participate in a company's future growth.

Unlike dividends for common stock, dividends for preferred shares are typically fixed, which can provide greater stability for someone who depends on that income. Those fixed dividends also tend to keep the price of a company's preferred shares more stable than that of its common stock.

Income investors often favor preferred stock over common stock because even though these shares generally carry no voting rights, they have a greater claim on a company's earnings than its common stock does.

Preferred shareholders must be paid dividends before holders of common stock. Also, preferred shares are in line before common stock for a share of the proceeds if the company goes bankrupt (though they are still subordinate to claims by bondholders).

However, this greater security involves trade-offs. Even if a company's earnings rise, preferred shareholders' dividends don't (though holders of what's known as "participating preferred stock" may receive some benefits).

Also, because their dividends are fixed, prices of preferred shares can be affected by changes in interest rates. As with bonds, if interest rates drop, that fixed dividend becomes more valuable; if rates rise, the opposite is true.

Being able to exchange convertible preferred shares for common stock is one way to address those concerns. If you like the idea of flexibility, convertible bonds offer a similar feature.

How do I compare convertible preferreds to common stock?

When evaluating the price of convertible preferred stock or deciding whether to convert it, you need to consider its conversion ratio and conversion premium.

A security's conversion agreement specifies either the conversion ratio (how many shares of common stock your convertible equals) or the conversion price at which common shares would be exchanged. A 3.5 conversion ratio means that each convertible share equals 3.5 shares of common stock.

The conversion ratio helps you gauge whether and when a conversion would make sense, and whether the share price is appropriate. To calculate what the common stock should be worth to justify switching (ignoring differences in dividend yields and liquidation preference), divide the price of each convertible share by the conversion ratio. For example, if you paid \$40 each for preferred shares with a conversion ratio of 3.5, the common stock price would need to be at least \$11.43 for a profitable conversion ($\$40/3.5 = \11.43). If you

converted at a lower price—say the common stock is at \$10 a share—you'd be trading your \$40 convertible for 3.5 common shares at \$10 each—a total value of \$35, not \$40.

Convertible shares typically trade higher than the conversion price. That difference is known as the conversion premium. In the above example, if common shares are \$10, a 3.5 conversion ratio means that the conversion premium is 14.3%. The \$5 difference between the \$40 convertible share and the \$35 it would be worth as 3.5 common shares represents a 14.3% premium above the common's price.

The conversion premium can help you judge how a convertible security may perform relative to common shares. The lower the premium, the more closely the convertible's fluctuations will track the common stock. A high conversion premium indicates the price of the convertible is based largely on its income stream, which can help keep its price more stable than that of the common stock. A financial professional can help you evaluate convertibles, and whether and when to convert.