Summer 2008

WORKING WEALTH℠
AT SMITH BARNEY

# DIALOGUES

FINANCIAL STRATEGIES FOR DISCUSSION℠

As your Financial Advisors, we value the client relationship we've developed. For us, it's a continuing process to stay actively involved with your personal financial goals and ensure that we're delivering great service to you. Your feedback is valuable and we welcome it anytime.

Courtesy of:

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## What's on Your Life List?

Set foot on all seven continents. Learn to play Beethoven's Piano Sonata No. 14 in C-sharp minor. Run the Boston Marathon. Having a "life list" of goals you want to achieve is a growing trend—look no further than the spate of books with the phrase "before you die" in the title, Web sites such as www.43things.com or the movie *The Bucket List*, starring Jack Nicholson and Morgan Freeman.

Similar to making a life list, retirement planning also involves identifying long-term goals. In fact, many of your life-list goals and retirement goals may be one and the same. Whether your retirement is 18 months down the road or 18 years, the planning process can help you identify what matters most to you. And because unexpected or milestone events can shift priorities, both your life-list goals and your overall retirement plan may be subject to change—it is life, after all.

When it comes to discussing your goals and creating your retirement plan, it's never too soon to start. At Smith Barney, we can help guide you through the planning process and access any resources you may require to implement your plan. If you already have a plan in place, it's important to revisit it on a regular basis, to ensure that it's consistent with your life list and the retirement goals you'd like to realize.

Whether it's your life list or your plan for retirement, it's exhilarating to think about the possibilities. But the best part is the clarity you can achieve to help you focus on what really matters—getting the most out of your life.

# IRA Rollovers: Stashing Your Retirement Nest Egg

Whether you are a Boomer saying goodbye to the daily grind or a Gen-Xer moving on to the next level of your career, retirement or a job change can create an ideal time to ask yourself what you want to do with your accumulated retirement funds. Unfortunately, there is no cookie-cutter answer to this question.

In pondering the next steps for your nest egg, you will need to assess the distribution options available to you and decide which ones will help you accomplish your goals. Here are just a few important reasons to consider an IRA rollover:

- You retain the tax-deferred status of your retirement investments.
- You have a broader array of investment choices in a self-directed IRA—and can craft a more appropriate portfolio to generate retirement income.
- You can structure a payout plan at any age that avoids the usual early-withdrawal penalty tax.
- An IRA rollover accommodates more customized beneficiary designations than most retirement plans.

Another important benefit of an IRA rollover is that it allows a surviving spouse to continue seamlessly with the IRA account—or consolidate it into his or her own IRA. Other beneficiaries, such as your children or grandchildren, also can receive payments from an inherited IRA over the course of their entire lives (this "stretch-IRA" strategy lets them take advantage of tax-deferred compounding while giving them the ability to spread the income-tax liability over many years). All IRA beneficiaries will be able to invest their self-directed IRA portfolios according to their individual needs.

## The Rollover Reconsidered

There are some situations where rolling over your nest egg to an IRA may *not* be a desirable course of action. Here are a few of those possible situations:

- If you retire between age 55 and 59½ and need income from this retirement account, you may want to leave some or all of it with your former employer in order to receive penalty-free distributions. (Income taxes are due upon withdrawal.)
- You were born before Jan. 1, 1936 and want to elect 10-year averaging tax treatment for your distribution from the employer plan. (ten-year averaging—which is also available to the beneficiary of someone born before Jan.1, 1936—is not available if you roll over to an IRA.)
- You are able to transfer from one employer's plan to another.
- You prefer the investment choices offered by your former or new employer's 401(k).

*Note: If your balance is less than $5,000, you may not be able to leave your 401(k) with your employer.*

Of course, a decision to *not* roll over your retirement nest egg to an IRA could impact your spouse, who down the road may have to deal with a former employer's plan representatives at a difficult time and make quick decisions—especially if immediate income is needed. Your spouse can roll over to an IRA in his or her own name, but if younger than age 59½, he or she will be at a disadvantage if income is needed. A spouse who inherits an established IRA can receive penalty-free withdrawals from that account at any age (taxes are due on withdrawals). As for nonspouse beneficiaries, the Internal Revenue Service issued regulations in 2007 that allow them to request a rollover to a beneficiary IRA. Unfortunately, the regulations are not mandatory for plan sponsors, so there is no knowing if your plan will allow your children or grandchildren to take advantage of an IRA rollover and the "stretch-IRA" strategy. It is then possible that your retirement assets could be exposed to immediate taxation.

To help you arrive at the best answer for how to manage your retirement account, we have a host of resources you can take advantage of, including a comprehensive planning tool that factors in elements such as any education funding you may be planning for your children or grandchildren. At Smith Barney, we want to help you consider the possibilities, weigh the outcomes and make informed decisions that result in your wealth working hard for you.

### Employer Stock and Your Retirement Plan

If a portion of your retirement plan consists of employer stock, net unrealized appreciation allows you to take a distribution of your shares and pay income taxes based on the cost basis rather than the market value. Ask your Financial Advisor for a copy of the report *Net Unrealized Appreciation on Employer Stock* or for a complimentary net-unrealized-appreciation analysis to compare the IRA-rollover and NUA strategies.

# Recessions and the Stock Market

## A Look at the Road Ahead

Weakness in many regional housing markets, as well as volatility in the global credit markets, have led some analysts to worry that the U.S. economy may be at risk of falling into a recession–a period of rising unemployment and economic contraction.

Many investors assume such a contraction would lead to a significant stock market downturn, such as the deep bear market that accompanied the 2001 recession.

There are valid reasons to be concerned about the strength of the U.S. economy, although most forecasters—including former Federal Reserve Chairman Alan Greenspan—are predicting a slowdown in the rate of growth, not an outright economic contraction. These concerns recently led the Fed to lower short-term interest rates for the first time since June, 2003.

### The S&P 500 During Periods of Recesssion

| Recession | Duration (in months) | Annualized Return |
|---|---|---|
| 1945 | 11 | +30.7% |
| 1948-49 | 11 | +15.7& |
| 1953-54 | 10 | +29.7% |
| 1957-58 | 8 | -2.3% |
| 1960-61 | 10 | +24.9% |
| 1969-70 | 11 | -1.9% |
| 1973-75 | 16 | -6.0% |
| 1980 | 6 | +19.8% |
| 1981-82 | 16 | +10.8% |
| 1990-91 | 8 | +12.7% |
| 2001 | 8 | -1.3% |

**Average Return: +12.1%**

Past Performance is not guarantee of future results.
Sources: National Bureau of Economic Research, Consulting Group

Investors also have good reason to fear that a recession would be a negative for the stock market. Economic contractions are often associated with sharp declines in corporate profits, which can push stock prices lower.

However, past experience suggests recessions and bear markets are not as tightly linked as many investors seem to think. According to the National Bureau of Economic Research—a private group that tracks the ups and downs of the U.S. business cycle—there have been 11 recessions since 1944. Yet, returns on the S&P 500 Index were positive in seven of those downturns. Indeed, returns on the S&P 500 averaged an annualized 12.1% during those recessionary periods, which is actually higher than the long-term return trend.

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At first glance, such a result may seem surprising, given that recessions typically have had the expected negative impact on corporate earnings. The Commerce Department reports profits have declined in 8 out of the past 10 recessions. Other things being equal, this could be expected to produce severe corrections in stock prices, if not outright bear markets. However, other critical factors can also play a role:

- **A rapid acceleration in inflation** may lead investors to doubt the future value of corporate earnings. Conversely, if a recession slows inflation, investors may become more confident about future earnings. As a result, stock prices might rise, or not fall as much as a decline in nominal earnings would suggest.

**For most individual investors, the prudent approach is to focus on long-term trends, while treating market corrections and economic downturns as opportunities either to acquire attractive stocks at temporarily distressed prices, or to sell stocks that no longer appear desirable.**

- **The Fed typically responds to a slowing economy** as it did recently—by lowering short-term interest rates. This may increase the attractiveness of stocks relative to fixed-income assets, supporting both valuations and prices.
- **Markets often rise and fall** for reasons that appear unrelated to trends in the real economy. The 1987 stock market crash, for example, took place even as economic growth was starting to accelerate.

Most importantly, investors need to remember that financial markets tend to focus on the future, not the present or past. This is why markets often turn volatile when the economic outlook grows uncertain, even if current conditions appear healthy. It is also why the stock market often recovers from a downturn before the economy does, as investors anticipate an improvement in earnings.

On the other hand, the market isn't always right. Many economic slumps widely predicted by analysts and investors have failed to appear. Thus the old joke: Wall Street has correctly predicted ten of the last five recessions. Even when recessions do lead to bear markets, there isn't necessarily a connection between the severity of the economic downturn and the depth of the stock market's decline.

Take the 1981-82 recession, for example. It was both deep and long, as the Fed raised interest rates to record highs to break an inflationary spiral. The stock market also fell, but recovered relatively quickly—perhaps because market valuations were depressed going into the downturn, but also perhaps because many investors were encouraged to see the Fed tackle inflation. The 2001 recession, on the other hand, was comparatively mild, but the stock market suffered its deepest bear market since the 1930s.

## Conclusion

There is no way to know if the economy is heading into recession, or what might happen in the stock market if it does. However, history shows that investors who have tried to "time" the economy—selling stocks when they think a recession in imminent and buying them back when they believe the economy has bottomed—have often been disappointed.

For most individual investors, the prudent approach is to focus on long-term trends, while treating market corrections and economic downturns as opportunities either to acquire attractive stocks at temporarily distressed prices, or to sell stocks that no longer appear desirable for fundamental reasons—potentially harvesting tax losses that can be used to shelter future capital gains.

The key to implementing a smart, long-term strategy is to have a carefully constructed plan. We are always available to discuss your individual strategy and to address any concerns you may have about your current plan and investment goals.

INDEX DEFINITION: The S&P 500 Index covers 400 industrial, 40 utility, 20 transportation, and 40 financial companies of the US markets (mostly NYSE issues). The index represents about 75% of NYSE market cap and 30% of NYSE issues. It is a capitalization-weighted index calculated on a total return basis with dividends reinvested.

# Built to Last:

## Generating Income in the New Retirement

Just as more sophisticated asset allocation strategies and approaches helped you grow your retirement savings, new thinking on asset allocation is now emerging as you prepare to start drawing down and spending these funds. Successful investing now refers to sufficient retirement cash flow. Risk is no longer defined solely by volatility; it is also defined by income shortages. In sum, you need a cash-flow plan that will help sustain your lifestyle in retirement while being flexible enough to absorb unforeseen expenses.

### New Retirement, New Needs

When figuring out your annual retirement cash-flow need, there are certain factors—beyond basic living expenses and the occasional indulgence—you should account for. Longevity is one. The Society of Actuaries, in their Annuity 2000 Mortality Table, suggests that for couples age 65 today, odds are that (assuming good health) at least one spouse will live to age 92, hence a need for longer-lasting savings. Health care is another factor. Assuming Medicare benefits remain at current levels, couples will need approximately $300,000 to cover health expenses in retirement if living to average life expectancy—and as much as $550,000 if living to age 95, according to the 2007 Retirement Confidence Survey of the Benefit Research Institute®.

In the face of longer lives and rising medical costs, if the fixed income component of your portfolio is too heavy, you could be increasing your risk of outliving your assets. An effective retirement portfolio certainly should generate an investment return that is high enough to meet after-tax expenses and outpace inflation while providing as much protection as possible. A periodic analysis of your asset allocation is important, especially once you begin tapping your accounts.

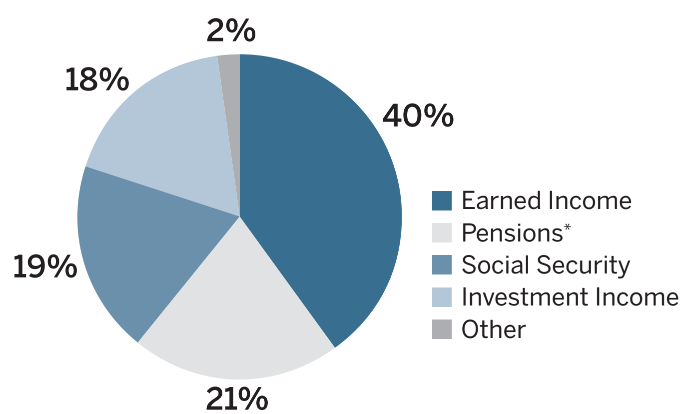
In the same way that members of the previous generation relied on pensions and Social Security to account for a large part of their retirement cash flow, today's boomers have an emotional yearning for a guaranteed source of income.

Certainly, assets in taxable investment accounts and 401(k) plans, IRAs and other tax-deferred accounts will comprise the bulk of retirement income for many people. But since investment returns are not guaranteed, income from these sources will vary with market performance. So, even though investments and other wealth may negate the need for Social Security, they can't provide the same peace of mind.

It's no secret that the worst possible time to experience a market downturn is when you have the greatest amount of money at stake, which is typically right before and right after retirement. Retiring, coupled with a sudden market downturn, can result in a serious shortfall in retirement income that usually can't be overcome using conventional investments and asset allocation strategies. Allocating a portion of your portfolio to guaranteed income sources can be helpful in mitigating that risk.

When it comes to your vision of retirement and the shift in needs that may accompany it, we can work with you to create a plan and build a portfolio that is designed to sustain you for the long haul.

### Where Will Retirement Cash Flow Come From?




Data Source: Morningstar as of March 1, 2007.
*Includes all defined benefit and defined contribution plans.

# Healthcare Planning for a Confident Life

## Making It an Integral Part of Your Financial Plan

This year, about nine million Americans over the age 65 will need some form of long-term care, and that number will reach 12 million by 2020. Although the majority of people who require long-term care are over the age of 65, a substantial 40% are between the ages of 18 and 64.1 Consequently, everyone should have reasonable provisions for healthcare financing in place.

Long-term care covers a range of services and supports, both medical and personal, to help individuals over an extended time with a chronic illness or disability (including cognitive impairments such as memory loss, confusion, or disorientation). The bulk of long-term care involves non-skilled personal assistance with performing "activities of daily living" (ADLs), such as bathing, dressing, toileting, getting around the house, and eating. Another category of assistance, "instrumental activities of daily living" (IADLs) includes preparing meals, shopping, bill paying and managing money, cleaning and other household chores, using the telephone or computer, and taking medication.

The chances of needing long-term care are higher for women (see accompanying box, "Women: Living Longer … but facing greater risks"). The chances also increase with age. For those 65 years or older, 60% will require at least some type of long-term care services during their lifetime and 40% will need care in a nursing home for some period of time. On average, older people today will need some long-term care services for three years (3.7 years for women, 2.2 years for men). However, one in five will need this care for more than five years. Long-term care needs often develop gradually and may include: home care from nurses, aides, therapists; community-based services; and care in a variety of long-term facilities.

### Assistance from Family, Friends, and Community

Perhaps the most important aspect of what you will want from long-term care is the ability to continue an active lifestyle with the greatest degree of independence as possible. While the above paid services can be extensive and partly or wholly covered by your insurance, most people also rely on help from family, friends, and community. Case managers, typically nurses or social workers, can assist you and your family in designing a practical regimen for long-term care needs.

The trend today is to help older people stay within the community, preferably living at home (or in a family member's home). Many communities offer adult day service programs, volunteer visitor/companion services, meal programs, transportation services, senior centers, and respite care—to give family members necessary relief to avoid caregiver "burnout." Home care may also include emergency response systems, and great advances in technology can now help family members monitor an older person's daily regimens while preserving a high degree of independence.

**Essential Legal Documents Concerning Your Medical Care**

In the event of incapacity, whether it is long- or short-term, there are several legal documents, called "advance directives," that everyone should have.

- Healthcare Power of Attorney: You can name your spouse, a child, a friend or anyone you choose as your Agent to make all healthcare decisions if you are incapacitated.
- Living Will: This documents your wishes concerning end-of-life treatment and what decisions you want your Agent and doctors to make.

Both of these should be on file with your physician and any hospital to which you are admitted. You should also consider signing enough copies so that your Agent can have access to originals if necessary.

You may also need a separate Power of Attorney for financial decisions. This should probably be constructed in very broad terms, giving the Agent the power to do anything you would ordinarily do, such as paying bills and making investment decisions. While a Power of Attorney does not allow an Agent to draw up a new will, it is effective upon signing and gives a person wide-ranging authority over your assets. Choose your Agent wisely, or the consequences could be highly damaging to you.

### Assisted Living Housing, Nursing Homes, Hospice Programs

Generally, there is a movement away from broad-based reliance on nursing homes if possible. This may include adult foster care homes, which provide room and board, 24-hour availability, help managing medications, and assistance with ADLs. Unlike skilled nursing homes, which are highly regulated and licensed by state governments, adult foster care homes and their licensing requirements vary greatly from state to state.

Assisted living facilities help people who need some level of care but not as much as they would receive at a nursing home. Residents often have their own apartments or rooms, but also receive support services—daily meals, assistance with personal care, help with medications, housekeeping and laundry, 24-hour security, on-site staff for emergencies, and social programs. Costs vary widely, and the requirements of these regulated facilities vary from state to state.

Families often turn to nursing homes for round-the-clock care when it is no longer possible to care safely or cost-effec-

Families often turn to nursing homes for 'round-the-clock care when it is no longer possible to care safely or cost-effectively for a person at home. The majority of nursing home stays are for less than a year, with 30% being less than three months. However, 20% of nursing home stays are for more than five years.[4]

Hospice programs, generally, help patients and families cope with terminal illness. Many patients are reluctant to use these programs because they are required to forgo advanced medical treatments in order to qualify. However, some hospices and private health insurers now allow more extensive medical treatment. The combination of services has already shown encouraging, life-prolonging results.[5]

## Long-Term Care Insurance

The costs for prolonged long-term care can be high. Frequently, Medicaid covers long-term nursing home residents, but you usually have to "spend down" your available assets (generally to $2,000) before you are eligible. Long-term care insurance can protect you financially in worst-case scenarios, and help you avoid the depletion of your estate. However, insurance for those worst-case scenarios is expensive, and only a small number of policy-holders need that much coverage. You may prefer a more modest policy that will cushion part of the financial drain.

These insurance policies typically cost less for younger people. Also, the older you are, the greater the likelihood that you will be denied coverage. Another consideration you should investigate before buying a policy is the rating and stability of the insurance company: Will they be around in 20 or 30 years when you need the coverage? While there is no guarantee, you should probably choose a carrier rated highly by Standard & Poor's, A.M. Best or Weiss Ratings.

## Acknowledge Healthcare Considerations

Healthcare, especially long-term healthcare costs, should be an integral part of your financial plan. Investors of all ages need to be aware of changing healthcare legislation and coverage, and should have reasonable provisions for healthcare financing in place. Let's talk about how to make smart healthcare and insurance decisions as part of your overall financial plan.

[1] *Understanding Long-Term Care*, National Clearinghouse for Long-Term Care information, www.longtermcare.gov.

[2] U.S. Census.

[3] Christine Larson, "In Elder Care, Signing on Becomes a Way to Drop By," *The New York Times*, 2/4/2007.

[4] National Clearinghouse for Long-Term Care, *Understanding LTC Services*, www.longtermcare.gov.

[5] Reed Abelson, "A Chance to Pick Hospice, and Still Hope to Live," *The New York Times*, 2/10/2007.

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**Women: Living Longer... But Facing Greater Risks**

- Older men are more likely to be married (71%) than older women (41%).
- Even among those 85 and older, 56% of men were married versus 13% of women.
- Older women are three times as likely to be widowed (44% compared with 14%).
- Half of older women age 75+ live alone.
- Older men receive most of their informal care from their spouses.
- Older women receive fewer hours of informal care than comparable men do, and most of that care is provided by their children and grandchildren.
- Among older nursing home residents, about 75% are women and most are widowed.
- Female nursing home residents are generally older, with more than half age 85 and over. This may be due to longer life expectancies and longer disability-free lifetimes.
- After entering nursing homes in old age, women tend to stay longer than men do. The average stay in a nursing home is 26 months for women, 19 months for men.
- On average, women are in the workforce for less time and make less money than men with comparable jobs.
- Women receive lower retirement benefits than men, and the median income for older women is less than 60% of the average for older men.
- Older women's long-term healthcare needs may be greater, yet their ability to accumulate assets is less and they typically need those assets to last longer.

Source for all statistics: U.S. Census Bureau, 65+ in the United States: 2005.

Long-term care insurance is medically underwritten. As such your actual premiums may vary from any initial quotation you receive. Premiums may increase during the term of the policy. You should not change or cancel your coverage until your new coverage is approved and in force. A change in contract may be subject to increased risk.

Investing in alternative investments is only intended for experienced and sophisticated investors who are willing to bear the high economic risks associated with such an investment. Investors should carefully review and consider potential risks before investing. Certain of these risks may include:

– loss of all or a substantial portion of the investment due to leveraging, short-selling, or other speculative practices;
– lack of liquidity in that there may be no secondary market for the fund and none is expected to develop;
– volatility of returns;
– restrictions on transferring interests in the fund;
– potential lack of diversification and resulting higher risk due to concentration of trading authority when a single advisor is utilized;
– absence of information regarding valuations and pricing;
– complex tax structures and delays in tax reporting;
– less regulation and higher fees than mutual funds; and
– advisor risk.

# Do You Have Time to Manage Your Investments?

Today's investment landscape is more complicated than ever before. New and complex financial products and services pop up and take root before investors have an opportunity to adapt.

Before investors ever get a chance to familiarize themselves with the current terrain, they must quickly adjust to a new landscape. Is it any wonder why staying informed and managing assets can easily become a full-time job? Weighing the available investment options and choosing wisely among them can require more time than investors have to give.

Which begs the question—how much time do investors have to give for managing their wealth? According to statistics from the U.S. Department of Labor (Bureau of Labor Statistics)—very little.

In the recent *American Time Use Survey 2004*, persons who worked full-time (worked 35 hours or more per week) on an average weekday spent 9.2 hours working, 7.5 hours sleeping, 3.0 hours doing leisure or sport activities and 0.9 hours doing household activities. The remaining 3.4 hours were spent in a variety of other activities, including eating and drinking, attending school and shopping.

With so much to do and so little time, how can any investor expect to stay informed and effectively manage their investment portfolios? That's why it's wise to consider partnering with an experienced investment professional, someone who will take the time to listen and understand your unique circumstances and design an investment strategy that can help you reach your long-term financial goals.

Whether you're investing for a child's education, managing your wealth for retirement or preserving assets for family heirs, we can design personalized investment strategies that can adapt to your individual circumstances and help you achieve your objectives.

## Average Work Day

### Do you have time to manage your wealth?


- **9.2 hours working**
- **7.5 hours sleeping**
- **3.4 hours eating, drinking, shopping, school, etc.**
- **3.0 hours leisure or sports**
- **0.9 hours household activities**

Source: U.S. Dept. of Labor, *American Time Use Survey, 2004*