



DIALOGUES

FINANCIAL STRATEGIES FOR DISCUSSIONSM



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Market Commentary

A Timely Update for Investors

The equity market staged a powerful rally ahead of the last Fed meeting on October 31; however, investor optimism quickly disappeared in the weeks following the 25 basis point cut as threats to economic growth and corporate profitability returned to the fore. The S&P 500 fell more than 9% over the next 17 trading sessions.

To us, the market's chief issue at present is the lack of concrete information about the breadth and magnitude of credit and derivative losses at major banks; in recent months, markets have reacted powerfully to small pieces of incremental data—both positive and negative. We expect this ebb and flow to continue as many of the questions facing the market have relatively "long tails" and will take time to resolve.

Going forward, Chief U.S. Strategist Tobias Levkovich maintains overweight recommendations in Semiconductor, Software, Retailing, and Media, along with Diversified Financial stocks. He is currently underweight the Food, Beverage & Tobacco, Household Products, Capital Goods, Utilities, Materials, and Real Estate sectors. He favors growth over value due to a range of factors, including the potential for corporate operating margin compression, attractive valuation and sector performance trends.

However, there are concerns about the direction of corporate profit margins and a potential increase in protectionist rhetoric that could pressure equity markets in the second-half of 2008, into 2009. Mid-year 2008 targets for the S&P 500 and Dow Jones Industrial Average are 1,725 and 15,500, respectively, dropping to 1,675 and 15,100 by year-end 2008.

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Time for Your Annual Wealth Management Check-Up

Too many people wait until they file their income-tax returns to evaluate the preceding year's finances and plan for the next. You should really begin much sooner, though, perhaps before year-end. This will give you plenty of time to analyze what you have accomplished and to plan for what you hope to accomplish. A checklist of questions might help.

- 1. What are your financial goals?** Before you do anything with your money, you should decide how you want to spend it. You should itemize what you have presently, what you need for the year ahead, and what you hope to have ten, twenty, or thirty years in the future.
- 2. Over the past year, have you made progress toward achieving your goals?** You should probably compare the performance of your investments to the goals you've established with regard to those investments for the year. The results of this analysis will help you decide whether or not you should alter your investments.
- 3. Are any changes about to occur that will affect either your immediate needs or your long-term goals?** A job change, for example, may drastically alter your income and your lifestyle. Other circumstances that may affect your finances might include buying a new house, financing an education, or paying for a wedding. Planning at least a year in advance will help you to adjust to these changes financially.
- 4. What can you do to reduce your taxes?** A general rule for tax purposes is to defer income to the next year while accelerating deductions for the present year. To defer income, you might postpone selling assets or you might also purchase Treasury bills or other investments that will mature the following year. To accelerate deductions, you might double up on your charitable contributions, pay your state taxes before year-end (if you are not subject to alternative minimum tax), or invest in a tax shelter.

Quite often people (who qualify) will also make contributions to their Individual Retirement Accounts at the last minute for an additional deduction. However, in the long run it's much better to make your IRA deposits early in the contribution year rather than wait until you file your income tax return for that year to take advantage of tax-deferred compounding.

- 5. Do you need any additional help to implement your plans for the future?** A lawyer, an accountant, a stockbroker, or a trust officer can be a tremendous help in any financial matters. If you're not progressing, as you would like, or if you find you don't have the time to manage your money properly, you might consider hiring a professional. It could be the one investment that makes all the difference.

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Investment Resolutions to Follow All Year Long

Here are a few resolutions that are easier to stick with than many of the traditional January vows. You do not have to overcome big obstacles to follow these tenets of investing, just develop a few good habits.

Re-evaluate Your Portfolio

Analyze your portfolio holdings considering your investment objectives, time horizons and life stage. If you have invested heavily in stocks and are approaching retirement age, you may want to consider reallocating a portion of your portfolio into high-quality bonds. Their long-term return potential may not be as high as stocks, but neither is their short-term volatility. As you get closer to the time when you will need these assets, you may want to consider shifting to more conservative investment vehicles to help reduce risk.

Take the Long-Term View

Consider the quality of a company before you invest and research its track record over five to ten years. Resist judging an investment solely by last year's return—past performance is no guarantee of future results. A good investment can have an off year and still provide outstanding returns over the long term.

Invest in a Blend of Securities

One time-tested way to help reduce risk in a portfolio is to diversify. That means holding a mix of stocks, bonds and cash-equivalent instruments from a variety of issuers. Younger, conservative investors who want to invest in stocks for long-term growth may want to consider investing a portion of their portfolio in corporate and government bonds. Investors of retirement age should keep in mind that inflation could erode the returns on short-term securities. Maintaining at least a minority portion of a portfolio in equities could improve the chances of keeping total return (yield plus capital gains) ahead of inflation. This strategy does not protect against loss.

Keep an Emergency Fund

Be prepared for unexpected cash needs: emergency medical bills, child care, home repairs and living expenses in case of a sudden job loss. Always keep a portion of your portfolio liquid.

Watch for Tax Developments

The amount you keep after taxes is the most accurate measure of your investment's performance. Your tax bracket, investment objective and changes in tax codes could make changing your investment strategy worthwhile. Consider speaking with your personal financial and tax advisors about whether tax-advantaged investments may be suitable for you.

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Leave a Legacy

In today's environment, it may be a good idea to consider investment strategies that allow you to leave an estate for your children, grandchildren, other heirs or a favorite charity as part of your overall financial plan. Such plans may not require as much updating as altering your investment objectives. A conversation with your tax and financial advisors could help your beneficiaries eliminate probate (a lengthy procedure whereby a court handles distribution of assets not designated to a beneficiary) and other estate planning issues.

Save Time and Money

Take advantage of the services offered by your brokerage firm. You could save yourself the trouble of delivering stocks and bonds to your financial advisor each time you're ready to sell an investment by having your securities held in the firm's street name. When you're ready to sell, just call your financial advisor.

Or consider consolidating your banking and investments into a central financial brokerage account.

You may be able to manage all your investing, savings, borrowing and spending in a single account. And some brokerage firms may supply you with an ATM card for convenient access to your funds.

A financial plan that includes the above, periodically monitored with the help of your financial advisor, could help make keeping your financial resolutions painless.

Year-End Needn't Be a Taxing Situation

Did you know that the Supreme Court ruled the income tax unconstitutional? That's right. The highest court in the land said that you could hold on to every red cent of the money you earned. No questions asked.

Don't pull a muscle jumping for joy just yet, however, because the Court's decision to end the income tax was rendered back in 1895 and for better or worse the income tax was subsequently re-enacted in 1913.

That year, Congress, authorized by the 16th Amendment, issued the first 1040 form in order to collect the 1% tax levied on net personal incomes above \$3,000 with a 6% surtax on incomes above \$500,000. In 1918, the income tax rose as high as 77% to help fund WWI and was later expanded to include payroll withholding and quarterly tax payments during WWII. Originally called the Bureau of Internal Revenue, the department changed its name in the 1950s to the Internal Revenue Service (IRS).

Today, the IRS processes over two hundred million tax returns and collects trillions of dollars in revenues. It enforces hundreds of complicated tax codes and can elicit sweaty palms and cold sweats for many individuals and professional tax preparers alike. Albert Einstein, one of history's greatest minds, once said about tax preparation, "The hardest thing in the world to understand is the income tax."

Year-end Tax Planning Checklist

- **Consider funding any retirement plans and nonqualified deferred compensation plans** that allow pretax contributions. Have your tax professional determine if you're subject to AMT for 2007.
- **Consider funding your flexible spending accounts**, but check with your company's benefits department as to the account's expiration regulations.
- **If you're a business owner**, let's talk about establishing a qualified retirement plan by December 31, 2007.
- **Let's talk about appreciated stocks** that you would like to give to charity.
- **Funding a tax-advantaged 529 College Savings Plan** is another topic we can discuss. You may be able to transfer over UGMA and UTMA funds.
- **Consider losses on securities** you may want to sell. I can guide you through the process of avoiding potential "wash sale" violations.
- **If you're age 70** or older, let's discuss taking a required minimum distribution from your Traditional, SEP or Simple IRA for 2006.
- **If you wish, you can transfer Traditional IRA withdrawals** tax-free to your favorite charity. I can show you how.
- **If you expect a tax bill in 2007**, let's discuss paying it without liquidating assets.

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