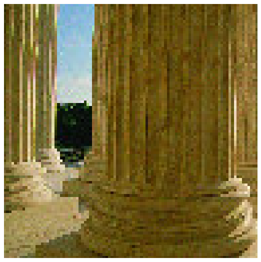
Third Quarter 2008

WORKING WEALTH℠ AT SMITH BARNEY

DIALOGUES

FINANCIAL STRATEGIES FOR DISCUSSION℠



Remember the mathematical axiom, The sum is greater than its parts? Well, the same is true of our team. We've combined our individual strengths to provide you with a higher caliber of service. We believe this is a win-win for you and us.

Courtesy of:

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Looking Beyond Short-Term Volatility

Whether you get your news from the papers, television or the Internet, you know how quickly the financial markets can change. Some days are euphoric (a key economic report may bolster consumer confidence or a company reports better-than-expected earnings for the quarter, igniting market indexes). Other days, however, aren't as sunny—and some of them may be downright unnerving. So what are some of the possibilities when an inevitable downturn occurs in the market?

An important piece of advice to keep in mind during a market slide is one you've no doubt heard before: Do not overreact. Even though your instincts may be telling you to try to protect your investments by switching to a more conservative approach or to liquidate your positions in hopes of buying them back at lower prices when the worst is over (an approach known as "timing" the market), it's important to keep your emotions in check—and your eyes on the long-term horizon. History tells us that over the long run the stock market can be quite resilient. From wars to natural disasters to economic meltdowns, the market has seen it all—and over time has shown remarkable capacity to bounce back.

While it's not always easy to maintain long-term perspective, overreacting to events as they unfold may compound the damage—and you may end up selling at the bottom or missing part or all of a subsequent market recovery. To help protect against short-term volatility and the anxiety it may create, together, we can help develop a diversified investment plan that reflects your long-term goals and tolerance for risk. By reviewing the investment plan on a periodic basis, we can try to alter it as needs change. At Smith Barney, our primary focus is ensuring that your wealth continues to work hard for you day in and day out.

Past performance is no guarantee of future results. Diversification does not ensure against loss.

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Funds for School

529 Plans Benefit Students and Donors Alike

With college costs rising faster than both wages and inflation year after year, it's not surprising that thousands of parents have seized the tax advantages of 529 savings plans to ease the strain of educating their children. But parents aren't the only ones. Thousands of grandparents are finding that 529s provide both an efficient estate-planning tool and a way to help their loved ones surmount one of life's greatest economic challenges.

The idea behind 529 plans is simple. Similar to a 401(k) retirement plan, a 529 is an investment account in which savings can grow on a tax-deferred basis until they are needed. The difference between 529s and IRAs, though, is that 529s enable you to designate a beneficiary who will ultimately use the money for educational expenses. When the money is withdrawn, there are no federal income taxes, as long as the money is used for qualified expenses, such as tuition, room and board, or textbooks.

Many states offer tax breaks as well. Legislation allowing for the plans was enacted in 1996 by the federal government but the plans are sponsored by state governments and available through brokers or direct.

Generation to Generation

Many grandparents are finding that 529s allow a convenient and tax-effective way to pass money along to their descendants—money that might otherwise have remained in their estates and been subject to hefty estate taxes before their descendants could inherit it. One of the primary advantages of 529s is that the person setting up the plan (the donor), not the person who will receive the money (the beneficiary), maintains control of the assets. With a trust, a child assumes complete control of the assets at a predetermined point in time.

If the beneficiary decides not to go to college, the 529 plan assets can be transferred to a new beneficiary. In fact, there are no restrictions on the number of times the plan can be transferred to a new beneficiary. If a donor ultimately decides not to use the money for education, capital gains must be paid, plus a 10 percent penalty, but only on the gain, not the principal.

> **Why stop at the grandkids? A beneficiary may use the money at any time, as long as it goes toward qualified expenses.**

Flexibility Matters

"One widespread misperception about 529s is that they must be used at specific universities, such as a state college," says Sheryl Colyer, Smith Barney Private Client Group. In fact, many 529 savings plans are administered through individual states and can be used at any approved educational institution. While all plans offer relief from federal capital gains taxes, some states further sweeten the pot by offering reductions in state taxes. Also, each state has a different cap on the total that can be invested in a single plan. Donors can purchase plans offered by any state, whether they live there or not, and can buy plans for as many beneficiaries as they like.

So why stop at the grandkids? After all, there's no limit on when the plans can be used. A beneficiary may use the money at any time, as long as it goes toward qualified expenses, Colyer says. With retirees living longer and more vibrantly than ever before, donors might even want to establish a 529 to go back to school themselves.

For Investors, Election's Winner May Not Matter:

A Q&A With Washington-Based Analyst Tom Gallagher

Thomas D. Gallagher lives at the intersection of policy, politics and financial markets, interpreting Washington's actions—or lack of them—for the investment community. And he's done it extraordinarily well, earning a spot on *Institutional Investor*'s All-Star team every year for the last 15 years. Tom is Senior Managing Director of International Strategy and Investment Group, which specializes in economic and political research.

How would you characterize the 2008 election?

This is the sixth presidential election I have covered as a Wall Street analyst, and it is the most interesting and consequential because it has the highest stakes. The Bush tax cuts expire at the end of 2010, and what happens to taxes will be very important for investors. There are many other important issues—foreign policy, health care, climatic change, to name a few. And don't forget that the first baby boomer will become eligible for full Social Security and Medicare benefits in the next presidential term. The budget pressure from the boomer retirements is going to be enormous.

The next president will have to tackle taxes. How would you expect that to play out under a President Obama?

Taxes will be the first order of business for whomever wins the election. What happens in part will depend on the state of the economy. We think the economy will be weak early next year and will be in need of fiscal stimulus, and I can foresee a bill that would cover such things as housing relief and infrastructure spending. Congress will pay for the bill by increasing taxes on upper-income taxpayers.

How much of an increase?

Most Democrats did not vote for the Bush tax cuts and, by policy and political inclination, they are looking to undo them. To give you an idea, the House recently passed a bill that goes back to the 2000 tax rates for the highest-income taxpayers. That's a marginal rate of 39.6%; on top of that, there is a 10% surtax, taking the top rate to about 44%.

And if McCain wins?

As a senator, McCain voted against the tax cuts. As a presidential candidate, he's backing them, and I expect him to stick to that position if he wins. But he doesn't have a strong hand. Remember, the Democrats can raise taxes to 2000 levels by taking no action, allowing the tax cuts to expire. Rather than let that happen, McCain will have to compromise. So taxes would go up, but not as much.

What about capital gains, dividends and the alternative minimum tax (AMT)?

The 15% capital gains rate goes back to 20% in 2011. But if there is no action on dividends, the maximum rate is the highest tax rate on ordinary income. For most investors, the dividend tax will at least double. Everyone wants to fix the AMT, but it's everyone's second priority. You'll probably see more temporary measures. Only in broad tax reform is a permanent solution likely.

So who will be our next president?

I see the election this way: Can personal attributes trump the public's sentiment for change? Can John McCain, a war hero who has an image as a maverick be seen as delivering more and better change than Barack Obama? I don't know. The Republican brand is on the decline, and issues like Iraq and the economy will be working against him. That makes Obama the favorite, but not overwhelmingly so.

First published in On the Markets, June 2008.

Did You Know?

One Day Does Not Make A Market

Each year, there are roughly two-hundred-and-fifty trading days on the major U.S. stock exchanges. For the average investor, that translates into over 19,500 trading days over the course of an average lifetime.

What should investors do when the inevitable unnerving downturn occurs? Investors should try to maintain a long-term perspective and avoid making impetuous investment decisions influenced by emotional impulses. After all, one day in the market does not a long-term investment strategy make. History reveals that over the long run, the stock market is quite resilient. From wars to natural disasters to economic meltdowns, the stock market has demonstrated the remarkable capacity to bounce back over time.

The table below identifies some of the worst one day trading sessions ever recorded in history as measured by percentage declines in the Dow Jones Industrial Average, one of the most widely followed stock market indices. The table also shows—with the exception of the Great Depression era, that more often than not, the markets tend to recover over the long run.

So, the next time the market turns down, don't let it turn your stomach upside down. Do your best to keep your emotions in check and for reassurance, consult with us.

Greatest Dow Jones Industrial Average Daily %Losses of All-Time 1896 – August 2007

Rank	Date	Close	%Change	Close 1 Year Later	%Change	Close 3 Years Later	%Change	Close 5 Years Later	%Change
1	12/12/1914	54.00	-25%	96.13	78%	67.30	25%	103.73	92%
2	10/19/1987	1,738.74	-22%	2,137.27	23%	2,520.79	45%	3188.00	83%
3	10/28/1929	260.64	-12%	194.95	-25%	63.09	-76%	93.01	-64%
4	10/29/1929	230.07	-11%	190.73	-17%	63.09	-73%	92.53	-60%
5	11/06/1929	232.13	-9%	180.72	-22%	61.53	-73%	96.06	-59%
6	12/18/1899	58.27	-8%	66.52	14%	61.18	5%	68.73	18%
7	08/12/1932	63.11	-8%	97.47	54%	128.00	103%	187.62	197%
8	03/14/1907	76.23	-8%	65.15	-15%	93.10	22%	85.12	12%
9	10/26/1987	1,793.93	-8%	2,165.18	21%	2,436.14	36%	3244.11	81%
10	07/21/1933	88.71	-7%	94.71	7%	165.23	86%	141.92	60%

Past performance is no guarantee of future results. Source: www.DJIndexes.com, Smith Barney