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 \* Member: Financial Industry Regulatory Authority • Securities Investor Protection Corporation

## Shaky Banks Prompt Focus on Deposit Insurance

Fifteen months ago, with the slump in home prices spreading, we noted that the nation's banks generally appeared to be in better shape than was the case heading into some previous financial crises. Since then a lot of write-downs and credit market surprises have flowed under the bridge. In July, California-based IndyMac Bank was seized by the Federal Deposit Insurance Corporation (FDIC) and may rank as the third-largest bank failure in U. S. history. During the second quarter the FDIC's list of "problem" banks grew from 90 to 117.

The FDIC was created in response to massive losses suffered by depositors in banks that failed during the Great Depression. It is funded by premiums collected from insured institutions, and in 1990 it gained the ability to tap a credit line with the U. S. Treasury. From 1990 to '92, the banking industry's last period of real distress, a total of 834 banks bit the dust. The FDIC's current assets of \$45 billion backstops nearly \$4.5 trillion of insured deposits. The IndyMac failure alone may cost it more than \$8 billion.

The FDIC covers individual accounts up to \$100,000 (including accrued interest) per depositor per bank, or \$250,000 for most retirement accounts. Deposits held under other types of ownership such as trusts may be insured separately, but check your specific array of accounts if this may be an issue. When the FDIC takes control of a bank, accountholders with some amount of *uninsured* deposits often can access a portion of those funds and may recoup a significant percentage over time from the sale of the bank's assets.

Brokered certificates of deposit issued by insured banks but held in a brokerage account are covered up to the same limits as if the deposits were held directly at the respective banks. So buying CDs from different issuers in one brokerage account *can* provide FDIC coverage at multiples of the \$100,000 per-institution limit. If one of those CD issuers fails, the brokerage firm conveys accountholder information to the FDIC and administers distribution of the funds claimed.

The FDIC does *not* insure stocks, bonds, mutual funds (including money market funds), or other securities holdings. The Securities Investor Protection Corporation (SIPC), funded by premiums from member brokerage firms, steps in if a firm fails financially and cannot meet its obligations to securities customers.

*[continued on page 4]*

## Did Anybody Hear a Whistle? Market View Flips from Fall '07

*"There must be some way out of here,"  
 said the joker to the thief.  
 There's too much confusion,  
 I can't get no relief.*

We doubt that Bob Dylan was offering up financial market commentary with those opening lines of his 1967 anthem, "All Along the Watchtower." Or was he? They do seem to capture this year's grinding test for even the most broadly diversified investor. As the little chart below shows, the trailing 12 months have been painful for every major sector of domestic and international equity fund. It's very nearly a mirror image of the trailing one-year returns sampled in these pages one year ago.

### 1-Yr. Snapshots Taken a Year Apart \*

| Mutual Fund Category    | Trailing 1-Yr. Total Returns |             |
|-------------------------|------------------------------|-------------|
|                         | thru 9/7/07                  | thru 9/6/08 |
| Large Cap Stocks (Core) | +13.9%                       | - 13.6%     |
| Mid-Cap Stocks (Core)   | +16.1%                       | - 11.4%     |
| Small-Cap Stocks (Core) | +11.9%                       | - 11.7%     |
| Foreign Stocks          | +19.5%                       | - 19.2%     |
| Emerging Market Stocks  | +40.1%                       | - 17.9%     |
| Flexible Portfolio      | +11.8%                       | - 5.9%      |

\* Source: Lipper, *Wall Street Journal* (see full table on page 2)

Some of the narrower sector bets that often counterbalance the major stock averages have been just as bloodied in 2008. China region funds are *down* an average of 35% year-to-date; Gold-oriented funds are down 26%; and Natural Resources down 11% – three sectors we suggested might be a bit over-extended last December. If you think the hedge funds are above it all, think again. According to Hedge Fund Research Inc., the rocket scientists who run those exclusive vehicles are posting the worst results of the 18 years that HFR has been tracking them.

There's always good old cash and money market funds, but yields are running less than current inflation, not a promising prospect for real long-term growth. If you missed the recent years' big moves in resources, commodities, and selected emerging markets, maybe this is another cautious entry point. All we know is that nobody will blow a whistle. §

## Concern and Criticism for Easy 401(k) Lending

Twelve years ago we examined the ins and outs of borrowing from your 401(k) retirement plan account. Notwithstanding those cautionary notes, outstanding loans from 401(k) plans have flirted with record levels this year – hardly surprising as falling home values and tighter credit have curtailed folks' ability to tap home equity for financial emergencies or more routine needs and desires.

Concerns are being raised anew from various quarters. The Financial Industry Regulatory Authority (FINRA) recently issued a warning about the use of 401(k) *debit* cards, and legislation was even introduced in Congress attacking this bit of plastic convenience for plan participants. In the real world 401(k) debit cards are not widely used. And even if your plan offers such a feature, you have to go through the normal loan process before you can start using it to fritter away your nestegg at Nordstrom or Starbucks. More to the point, cards don't borrow from their retirement plans, people do, and often for well-considered reasons or as a least-bad alternative.

Advisors have long cautioned those who would borrow from their plan accounts, fearing they may not fully understand the costs and pitfalls of such financing. Many plans charge fees for establishing and administering loans. More critically, borrowing from a 401(k) account can undermine long-term retirement savings goals. Money borrowed from your plan misses out on your diversified portfolio's investment results. And even though your account may be credited most of the interest you pay back with the loan principal, that interest also comes from *your* after-tax discretionary income.

Nevertheless, in a real pinch a manageable 401(k) loan is often a better option than an outright plan withdrawal with its attendant tax consequences. As more 401(k) sponsors automatically enroll employees for salary deferral contributions there will be a continuing need for some participants to access those funds.

Finally, one could probably make a reasonable case for taking a small loan from the 401(k) account of *one* spouse if that's the only way to afford a deductible contribution that would qualify for a match from the *other* spouse's employer. Consult very carefully with your financial and tax advisors before embarking on *that* particular strategy. §

## Social Security Website Makes It Even Easier to Project *Your* Retirement Benefits

The Social Security Administration continues to gear up for the wave of Baby Boomers fast approaching retirement. The agency's website ([www.SSA.gov](http://www.SSA.gov)) recently unveiled a new estimator that produces a *personalized* projection of your Social Security retirement benefits by drawing on your actual earnings record in the Social Security database.

It takes just a few clicks of your mouse and a few pieces of basic personal information such as your name, Social Security number, birthdate and place, etc. Based on those records the estimator calculates average earnings over your working life, assuming that you continue to earn at about your current level until retirement.

This is similar to the method behind the estimates in the Social Security statement you receive each year in the mail. But with the online estimator you can pull an update any time. Of course the closer you are to retirement age the more accurate the estimate will be. Otherwise the remaining variables of future earnings and wage inflation are significant.

The Social Security Administration has a few other tricks up its sleeve for the Boomers. This fall the agency plans to introduce an updated online benefits application designed to trim that process from about 45 minutes down to 15 and eliminate the need for new retirees to make a follow-up trip to their nearest Social Security field office. Over the years you may have noticed that the government is pretty proficient at getting money *from* you during your working years. It's good to know they continue to look for efficiencies in getting it to you as well. §

### Performance Summary: Major Mutual Fund Categories\*

| Mutual Fund Category       | Total Return w/ Dividends and Capital Gains Reinvested |       |       |        |
|----------------------------|--|-------|-------|--------|
|                            | ---- Annualized through Sept. 5, 2008 ----             |       |       |        |
|                            | 1 yr.  | 3 yr. | 5 yr. | 10 yr. |
| Large-Cap Stocks (Core)    | - 13.6%  | 2.0%  | 5.1%  | 3.7%   |
| Mid-Cap Stocks (Core)      | - 11.4   | 3.4   | 8.4   | 10.4   |
| Small-Cap Stocks (Core) †  | - 11.7   | 2.2   | 8.0   | 9.8    |
| Foreign Stocks †           | - 19.2   | 4.8   | 11.0  | 6.4    |
| Emerging Market Stocks †   | - 17.9   | 13.4  | 20.0  | 16.1   |
| Flexible Portfolio         | - 5.9  | 4.4   | 7.4   | 6.7    |
| General Bond               | 1.2  | 3.1   | 4.9   | 5.4    |
| Int'l Income (non-U. S.) † | 5.4  | 3.2   | 5.6   | 5.6    |
| High-Yield Taxable Bond †  | - 2.5  | 2.6   | 5.4   | 4.4    |
| General Municipal Debt     | 2.1  | 2.1   | 3.5   | 3.8    |

\* Source: Lipper, as reported in the *Wall Street Journal*, September 6, 2008.

Past performance is NOT indicative of future results.

† Small-cap stocks and high-yield (lower rated) bonds pose greater risk and price volatility than securities of larger, well-established companies. Securities of companies based outside the U.S. may be affected by currency fluctuations and political or social instability to a greater extent than U.S.-based companies.

## A Chance to Capture Some Capital Gains *Tax-free*

This election season is featuring a little discussion of capital gains taxes – specifically how much one side wants to raise them if elected. But for now a window has opened for individuals in the 10% and 15% tax brackets to pay 0% on their long-term capital gains. Barring a change in the law, the window is open through tax year 2010.

The benefit may be most intriguing for those with a measure of control over the sources they tap for living expenses, as well as for inter-generational gifting. For 2008 the 15% bracket tops off at \$32,550 of taxable income for an individual or \$65,100 for joint filers. Any realized gains add to that income figure, so strategizing around the provision can be tricky.

Some retirees may realize a benefit by reducing taxable withdrawals from retirement accounts and making up that dent to cash flow by paring some taxable holdings that have unrealized gains. Or, if you're providing some support to a younger taxpayer, a gift of appreciated securities could be extra tax-efficient, especially if that gift helps the recipient fund a deductible IRA or 401(k) contribution and qualify for the Saver's Credit as well.

Individuals can give up to \$12,000 per year to another person without filing a gift-tax return, so a couple could bestow up to \$24,000 on some very grateful recipient. But remember that under the "Kiddie Tax" rules, if you provide more than half the support for your child (to age 24) who is a full-time student, his or her *income* may be subject to *your* tax rate.

Another thought: Parents often end up subsidizing health insurance for a while for their 20-something children who are no longer dependents. A high-deductible individual policy often makes the most sense, and that creates eligibility for a Health Savings Account. Contributions to the HSA are deductible up to \$2,900 for an individual and \$5,800 for a family. Rather than just covering premiums, you might help the kids find a high deductible policy and fund an HSA. They can deduct the contribution without having to itemize, and if they *need* the money to cover premiums or other qualifying medical expenses, the HSA can be tapped without tax or penalty.

## Term Life Insurance Rates Have Been Falling for Years

These days it's costing a lot more to gas up the car and fill the grocery cart, but life insurance keeps getting cheaper. In fact, premiums for term life coverage have been on the down escalator for years. They fell an average of 15% per year from 1994 to 1999 and have eased lower at about a 4% annualized pace since then. Assuming comparable age and health, today's rates are about half what they were a dozen years ago.

One reason for lower rates is the incorporation of a newer Commissioners Standard Ordinary (CSO) Mortality table to calculate premiums. The new table projects the average 65-year-old male to live to age 81, up from 78 under the old table. More importantly, death rates among the prime life-insurance-buying age range, 25-44-year-olds, have dropped more than 10% since 1994. Insurers must use the new CSO table as of January 1, 2009, and many have already incorporated it into their pricing.

Consolidation across the insurance industry and advances in technology have improved operating efficiencies. That too fosters lower premiums in a competitive insurance marketplace. These days a 40-year-old male nonsmoker can secure a \$500,000, 20-year level term life insurance policy for about \$750 per year as a "standard" risk, or around \$400 if his health profile qualifies him as a "preferred" risk. Even at age 50 comparable coverage is only a few hundred dollars more per year. Rates for women run even lower, all other factors being equal.

There's more to buying life insurance than knowing that the cost of basic coverage has fallen. But it does suggest that cost alone should not be an impediment to protecting against such risks as the loss of a family's breadwinners or a business's key employees. Check with your KMS Representative to review your life insurance needs and current coverage. §

If it's really time to sell a long-held asset, capital gains taxes are hardly onerous enough to justify heroic efforts to avoid them. But check with your tax professional if you think the window for capturing some gains at a 0% rate might be an opening for you. §

## Gains-Tax Exclusion Curtailed for Some Home Sales

The recent housing bill carried a little-noticed provision that could boost capital gains taxes on the sale of some homes. Homeowners enjoy tax-free gains of up to \$250,000 (\$500,000 for a married couple) on the sale of a home used as a *principal* residence for at least two of the five years prior to sale. But under the *new* rule, the exemption will be based on the time the home actually served as the principal residence.

For example, if a property is used as a vacation home for three years and then as principal residence for the two years prior to sale, at least 60% of any gain would be taxable. It doesn't matter in which years the appreciation occurred; the exemption is figured *pro rata* as above. The rule takes effect January 1, 2009. Anyone already using a home as a principal residence by then should fall under the old rule at sale time. §

## Global Growth Adding to Global Girth

Perhaps it was inevitable; the spread of global prosperity is spreading global waistlines. And while the U. S. has led this particular expansion for years, others are catching up. A sustained rise in agricultural production and expanding trade is delivering more calories to more dinner tables than ever before. Across the 30 nations of the Organization for Economic Cooperation and Development, daily caloric intake per person grew 15% from 1963 to 2003. And the long-term shift from manufacturing and physical labor to service-based economies has led to more sedentary lifestyles.

The U. S. Centers for Disease Control report that from 1995 to 2007, the percentage of American adults considered obese jumped from 16% to 26%. Diabetes diagnoses grew at about the same pace over that span of years. Obesity is also associated with significantly higher incidence of heart disease, high blood pressure, joint degeneration, and certain kinds of cancer.

The health and public policy implications are

significant, and those concerns are going global. The World Health Organization has pegged the number of obese adults at 700 million worldwide as of 2005, their most recent estimate and a big jump from a decade earlier. China has seen a surge in consumption of rich food; the WHO estimates that 70 million Chinese are now obese. Together, India's and China's populations are believed to include more diabetics than all other industrialized countries combined.

Much is made of the burgeoning demand for consumer goods and services across these emerging economies. It looks like some of those areas of rapidly growing demand will be related to healthcare. §

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### ***Shaky Banks... [continued from page 1]***

The SIPC does *not* protect against losses from the rise and fall in market value of such investments; it simply insures that those holdings are there for the investor. SIPC covers up to \$500,000 of value per accountholder, including \$100,000 for claims for cash held on deposit with the firm. Many firms institute coverage for substantially larger account balances through private, commercial insurers. Further information on SIPC and FDIC coverage is available at:

**FDIC:** [www.FDIC.gov](http://www.FDIC.gov) / (877) 275-3342

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